LEGISLATIVE BUDGET ANALYSIS
SPECIAL SESSION
AUGUST 2002
FOR THE FISCAL 2003 BUDGET

Projected Deficit
Legislative Budget Options
Executive Budget Proposal

A Report Prepared for the

57th Legislature

By the

Legislative Fiscal Division

July 23, 2002

www.leg.state.mt.us/fiscal/

MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building * P.O. Box 201711 * Helena, MT 59620-1711 * (406) 444-2986 * FAX (406) 444-3036

Legislative Fiscal Analyst
CLAYTON SCHENCK

July 23, 2002

Members of the 57th Legislature:

In accordance with 5-12-302, MCA, I submit for your consideration the Legislative Fiscal Division budget analysis for the August 2002 special session. It is our goal that this analysis provide the fiscal information necessary to assist committees and legislators in efforts to resolve the current budget deficit.

This report is designed to be a working document for appropriations and taxation committees, and all legislators. The report includes:

- An overview of the current budget shortfall, including the executive projected general fund deficit, the legislative staff projections, and reasons for the deficit
- Legislative options for dealing with the budget shortfall, including a summary of how other states have dealt with recent budget deficits
- The executive budget proposal and an analysis of the components of the proposal
- The 2005 biennium budget outlook

A separate report contains the revised revenue estimates of the executive and LFD, the underlying economic assumptions, and an explanation of the differences between the executive and legislative estimates. It is intended as a working document for the taxation committees in developing the revenue estimating resolution.

Your staff of the Legislative Fiscal Division look forward to being of service to the legislature during this special session. We are here to assist legislators in obtaining the best possible fiscal information for making the difficult decisions that lie ahead. Please feel free to call on us to assist in your deliberations.

Respectfully submitted,

Clayton Schenck
Legislative Fiscal Analyst

Table of Contents

PURPOSE OF REPORT

The 57th Legislature has been called into special session to bring the general fund budget into balance as a result of a projected deficit for the 2003 biennium. The purpose of this report is to provide the Legislature:

- an independent analysis and summary of the existing budget deficit
- legislative options for resolving the deficit
- a summary and analysis of the executive proposed budget plan
- a broadbrush overview of the fiscal outlook for the 2005 biennium

A separate report provides a summary of the general fund revenue estimates as projected by the executive and by your LFD staff.

As noted throughout this report, there are a number of dynamic economic conditions that may change the final outcome of revenue and budget projections for the 2003 biennium. Of primary concern is the uncertainty of income tax collections, which have shown a significant downward trend. Further, the actual fiscal 2002 year-end numbers will be available within a few days after this report is published and before the start of the special session. This report will be updated as needed should revenue projections or proposed spending reductions change significantly prior to the Special Session.

BUDGET SHORTFALL

BACKGROUND

For nearly a decade, states have enjoyed a strong state budget picture. Especially in recent years, states underestimated the strength of general fund revenue flows from a robust economy and a strong stock market. States were caught off guard when the national economy went into a recession in early 2002, further aggravated by the unpredictable events of September 11 and a receding stock market. States with sales taxes and large manufacturing/corporate sectors felt the impact first, while states like Montana, with a high dependence on income taxes, didn't feel the full impact until calendar 2002. This mild recession on a national basis has hit states much harder than the more severe recession of the early 1990s, largely due to the increased share of state revenues from capital gains during an unprecedented period of stock market growth. While states anticipated a drop-off in capital gains revenues, the impact was far more severe than anticipated. Montana's state budget decline has been below the national average, yet there has been a dramatic decline in revenues that didn't become fully apparent until the cycle of income tax revenue collections reached its peak in mid-2002.

In November 2001 and in a series of reports since then, this office reported to the Legislature that Montana was experiencing a sharp decline in general fund revenues. On April 18 the Governor's Office formally announced concerns about a budget deficit, and initiated proceedings to implement spending reductions in accordance with 17-7-140, MCA. On June 22, the Governor directed spending reductions of $23.7 million and at the same time called for a special session of the legislature to deal with a budget deficit that had deteriorated further than the Governor felt could be dealt with under the limited authority of 17-7-140 (the Governor's Special Session call is in Appendix A).

The following discussion provides current projections of the general fund deficit, the differences between 2001 session projections, legislative staff projections, and executive projections, and reasons for the revenue shortfall. The revised revenue projections from the Office of Budget and Program Planning and the LFD are explained in more detail in the LFD Revenue Estimates report (separate document), along with an explanation of differences.

GENERAL FUND DEFICIT

The 57th Legislature adjourned the 2001 session with a 2003 biennium budget that provided for a projected general fund reserve of $54 million. For the first several months following the 2001 session, state general fund revenues came in even stronger than projected in the revenue estimate resolution for fiscal 2001, and then held steady in early fiscal 2002. In November 2001, the Legislative Fiscal Division reported a significant downturn in general fund revenues and a concern that if the trend continued, the projected ending fund balance would be significantly less than anticipated. The trend continued to worsen, and in early April the LFD reported that a preliminary estimate of the biennium ending general fund balance was $28 million. This placed the projected balance near the statutory trigger point for implementing spending reductions. In late May, this office and the Office of Budget and Program Planning estimated a negative general fund balance for the 2003 biennium, and the executive began the process of identifying spending reductions. Individual and corporation income tax collections were the primary reason for the need to implement spending reductions. These two sources are now projected to be $151.1 million below HJR 2 revenue estimations.

Legislative Projection, 2001 Session

As shown in Figure 1 (column 1), the 57th Legislature projected a general fund ending fund balance of $53.8 million on June 30, 2003, which is a reserve of 2.3 percent of general fund appropriations for the biennium. Those projections included an average growth in general fund revenue. Which assumes a less robust growth pattern than immediate past biennia, but still a consistent growth. Stronger than anticipated revenues at the end of fiscal 2001 signaled an even brighter picture, with an increased fund balance of $62.2 million, leaving a projected balance on June 30, 2003 of $116.5 million. However, column 2 of Figure 1 shows the revised LFD projections, reflecting a number of predominantly negative impacts on the general fund balance that have sharply reduced the projected fiscal 2003 ending balance. The projected ending fund balance has declined by $112 million prior to budget reductions, leaving a deficit of $58.3 million. The Governor directed spending reductions of $23 million along with voluntary reductions of $0.7 million, leaving a projected deficit of $34.6 million prior to any legislative action, using LFD projections.

Figure 1
Comparison of 2003 Biennium General Fund Balance
Post-Session Budget vs. July Revised Budget
In Millions

	Post Session 2003 Biennium	Revised July 2003 Biennium	Difference 2003 Biennium
Beginning Fund Balance	**$110.729**	**$172.897**	**$62.168**
Revenues			
Current Law Revenue	2,677.566	2,531.664	(145.902)
Total Funds Available	**$2,788.295**	**$2,704.561**	**($83.734)**
Disbursements			
General Appropriations	2,274.123	2,274.123	
Statutory Appropriations	92.195	279.906	187.711
Local Assistance Appropriations	326.739		(326.739)
Miscellaneous Appropriations	8.483	160.910	152.427
Non-Budgeted Transfers	31.930	37.522	5.592
Continuing Appropriations		2.611	2.611
Supplemental Appropriations		17.366	17.366
Feed Bill Appropriations	7.028	7.028	
Executive Reductions		(23.400)	(23.400)
Legislative Reductions		(0.350)	(0.350)
Anticipated Reversions	(6.027)	(14.269)	(8.242)
Total Disbursements	**$2,734.471**	**$2,741.447**	**$6.976**
Adjustments		2.324	2.324
Reserved Ending Fund Balance	**$53.824**	**($34.562)**	**($88.386)**
Unreserved Ending Fund Balance	**$53.824**	**($34.562)**	**($88.386)**
New Information Since Adjournment			
Shell Oil Audit Settlement	12.841		(12.841)
Potential Ending Fund Balance	**$66.665**	**($34.562)**	**($101.227)**

Executive Projection

The Executive Budget Plan assumes an ending general fund balance projection of a negative $22.0 million prior to implementing legislative spending reductions and fund transfers (Figure 2, column 1). The estimates project a significant downturn in individual income taxes, corporation income taxes, investment earnings, and motor vehicle revenues, in addition to a significant impact of the federal economic stimulus act.

Figure 2
Comparison of 2003 Biennium General Fund Balance
Executive Budget vs. LFD Budget
In Millions

	Executive 2003 Biennium	LFD 2003 Biennium	Difference 2003 Biennium
Beginning Fund Balance	**$172.850**	**$172.897**	**$0.047**
Revenues			
Current Law Revenue	2,530.166	2,531 664	1 498
Total Funds Available	**$2,703.016**	**$2,704.561**	**$1.545**
Disbursements			
General Appropriations	2,272.550	2,274.123	1.573
Statutory Appropriations	278.530	279.906	1.376
Local Assistance Appropriations			
Miscellaneous Appropriations	162.840	160.910	(1.930)
Non-Budgeted Transfers	37.590	37.522	(0.068)
Continuing Appropriations	2.290	2.611	0.321
Supplemental Appropriations	5.580	17.366	11.786
Feed Bill Appropriations	7.200	7.028	(0.172)
Executive Reductions	(23.400)	(23.400)	
Legislative Reductions	(0.350)	(0.350)	
Anticipated Reversions	(15.540)	(14.269)	1.271
Total Disbursements	**$2,727.290**	**$2,741.447**	**$14.157**
Adjustments	2.320	2.324	0.004
Projected Ending Fund Balance	**($21.954)**	**($34.562)**	**($12.608)**

Executive Proposals to Reduce Deficit			
DOR Residual Equity Transfer - June	0.400	0.400	
Eliminate DOT Transfer - June	5.790	5.790	
Executive Proposal - August	45.260	45.260	
Potential Ending Fund Balance	**$29.496**	**$16.888**	**($12.608)**
Calculated Target Ending Fund Balance	27.162	27.176	0.014
Projected Budget Gap	**$2.334**	**($10.288)**	**($12.622)**

The projections leave a shortfall of $49.1 million from the statutory minimum ending balance required by 17-7-140, MCA, and the executive plan includes spending reductions and budget transfers that would bring the projected balance to $29.5 million. The executive proposed budget balancers and the target ending fund balance as shown in the bottom box of Figure 2 are discussed in more detail in the section "Executive Proposed Budget Plan" on page 33.

LFD Projection/Differences from Executive Plan

The LFD projected general fund deficit prior to any legislative action in special session is a negative $34.6 million. This compares to the Budget Director's projection of a negative $22.0 million. A comparison of the two projections and the difference of $12.6 million is shown in Figure 2. The differences between the two are highlighted in Figure 3 and are explained below. The "All Other" category in Figure 3 is a net of all other balance sheet categories, and differences are primarily due to different categorization between the two projections. A detailed LFD balance sheet is in Appendix B.

Figure 3
Comparison of Major General Fund Differences
Executive Budget vs. LFD Budget
In Millions

	2003 Biennium
Revenue Estimates	$1.498
Supplemental Appropriations	(11.786)
Anticipated Reversions	(1.271)
All Other	(1.049)
Total Difference	**($12.608)**

Revenue Estimates

The difference between the executive and the LFD general fund revenue estimates for the 2003 biennium are $1.5 million, or only 0.06 percent of total revenues. Total general fund revenues as projected by the LFD are expected to be $2.5 billion for the 2003 biennium.

In general, both the executive and the LFD independently examined each revenue source in detail. Fiscal 2002 year-to-date collection trends were reviewed as well as relevant economic conditions.

Figure 4
2003 Biennium Revenue Estimate Differences
Executive vs. LFD

Revenue Category	Millions
Corporation Income Tax	$2.965
Public Institution Reimbursements	(3.717)
Remaining Categories	(0.746)
Total Difference	**($1.498)**

Figure 4 shows the primary differences between the two estimates, with only two significant differences that are largely offsetting. The differences are discussed in detail in a separate report on revenue estimates. Final revenue estimates could be significantly influenced by final actual fiscal 2002 collections and revenue accruals processed during the fiscal year-end closeout period. The final fiscal 2002 data will not be available until July 27. This daa will not only impact final collections for fiscal 2002 but will also affect the outlook for fiscal 2003. Both the LFD and executive projections will be updated prior to the special session to reflect the updated information.

Supplemental Appropriations

As shown in Figure 5, the LFD estimates are $11.8 million higher for supplemental appropriations, which is primarily due to the LFD inclusion of $3.9 million for a supplemental appropriation for Public Health and Human Services and an estimate of $7.3 million in fiscal 2003 for wildfire suppression costs. The executive plan included estimates for anticipated supplementals for Spring 2002 wildfires and for Department of Justice litigation costs, on the basis that those costs would not be mitigated by the agency, and that they would submit supplemental requests to the legislature for those costs. The LFD projections include the two additional anticipated supplemental requests for the following reasons:

- DPHHS Fiscal 2002 Cost Over-run: The executive submitted a report to the Legislative Finance Committee in June 2001 stating they would transfer $3.9 million from fiscal 2003 to fiscal 2002 due to a funding shortfall based on PHHS projections. The report also stated that the full amount would be requested as a supplemental appropriation for fiscal 2003. A plan for mitigation of the costs was not submitted. Since the executive plans to request the supplemental from the legislature, it should be included in the projected deficit. Non-inclusion of the estimated PHHS supplemental in the executive budget plan is inconsistent with the executive treatment of other projected over-runs they do not intend to mitigate.

Figure 5
Supplementals
Executive/LFD Projections
(millions)

	Executive	LFD	Difference
Spring Wildfires (fiscal 2002)	$5.3	$5.9	$0.6
Dept Justice Litigation	0.3	0.3	0.0
PHHS Fiscal 2002 cost over-run		3.9	3.9
Wildfire Costs, fiscal 2003		7.3	7.3
Total Included in Projections	5.6	17.4	11.8
Potential Cost Over-runs (not in Projections)			
PHHS - Medicaid Waiver		2.8	2.8
Corrections - Prison Population		9.0	9.0
Total Potential Supplementals	$5.6	$29.2	$23.6

- Wildfire Costs, Fiscal 2003: The executive does not include an estimate for wildfire suppression costs for the 2002 summer fire season (fiscal 2003), even though some costs have already been incurred, and a supplemental will clearly be required. The LFD estimate of $7.3 million is an average annual fire suppression cost, which is a conservative estimate in view of the improved yet still existing drought conditions the state is experiencing. Since this is a highly probable cost that will occur in fiscal 2003 and is unbudgeted, it should be included in any viable projection intended to project a shortfall for the purposes of addressing that shortfall.

Since no estimate is included in the executive plan for the two additional projected supplementals, the final ending fund balance projected by the executive can be expected to be $9.9 million less (net of $1.9 million federal reimbursement revenue for wildfires), and therefore below the minimum required target by $10.3 million.

It is emphasized that these supplemental projections are included because they are very likely to occur based on best available information, and the executive does not plan to mitigate these costs. Ultimately, the legislature will determine if they will approve the supplemental requests, although historically the legislature funds wildfire suppression cost supplementals as there is no other budget provision for them.

As shown in the bottom half of Figure 5, there are two other areas with potential cost over-runs, based on current information, that could result in supplemental requests. They include an additional $2.8 million in Public Health and Human Services and approximately $9.0 million in Corrections. The legislature should be aware of these potential over-runs, but understand that they are not included because the executive has the option to mitigate those cost over-runs by re-prioritizing or applying cost saving measures. The executive has not stated whether these cost over-runs will be mitigated. The $2.8 million in PHHS is due to planned reductions that are contingent on receiving a Medicaid cost waiver from the federal government in fiscal 2003. Based on the length of time other states have experienced in obtaining the

waiver, it is unlikely the waiver will be approved in time to obtain a fiscal 2003 savings. Since the department has already had to make significant reductions both to stay within the fiscal 2002 budget and as part of fiscal 2003 reductions directed by the Governor, it will be difficult to mitigate the over-run. An LFD issue with the proposed waiver is presented in Appendix E of this report.

The $9.0 million cost over-run in Corrections is due to greater than anticipated prison population projections, but the executive plans to seek ways to reduce total prison populations. If this cost over-run cannot be fully mitigated, there is a strong likelihood of a supplemental request for the 2003 biennium.

If the full amount of all of the four potential supplemental requests excluded from the executive projections were to occur, the final ending fund balance projected by the executive could be expected to be $23.6 million less, and therefore below the minimum required target by a total of $21.2 million.

Anticipated Reversions

Anticipated reversions have been adjusted to reflect a lower expected reversion due to a tight budget situation and the spending reductions assessed to agencies. The LFD projection anticipates a lower reversion than the executive plan, a difference of $1.3 million.

REASONS FOR DECLINING GENERAL FUND BALANCES

The revenue stream for the state has undergone a dramatic change in the past nine months. In general terms, the revenue downturn can be attributed to a dramatic decline in net capital gains income due to the prolonged decline in the equity markets. Additional factors are an economic slowdown that slipped into an economic recession because of the September 11 terrorist attacks, and the economic stimulus act passed by Congress in February.

In more detailed terms, the causes of the revenue drop-off are not totally clear. The primary revenue component impacted by an economic slowdown and reduced net capital gains income is individual income tax, which comprises about 44 percent of all general fund revenue. Individual and corporate income tax collections are down 10.6 percent in fiscal 2001, and the overall impact is still unclear since final revenue accruals for fiscal year 2002 aren't yet available. The most dramatic decline occurred in April. It will not be possible to pinpoint specific causes until much later this calendar year when all returns have been processed and analyzed. Reduced net capital gains and investment income are obvious explanations, but the relative contribution to the shortfall is still unclear.

So why did the sudden decline catch us by surprise? Clearly, no one could have predicted the events of September 11 and their impact on the economy and investors' loss of confidence due to concerns whether other attacks will occur. Further, the loss of confidence due to corporate accounting scandals contributed to the unprecedented decline in the equities markets. Still, the magnitude of the impact on state revenues has been puzzling, and has resulted in larger deficits than the stronger recession of the early 1990s. One state required three special sessions before it addressed the full effect of the spiraling deficit.

The decline in general fund revenues below projections is not unique to Montana – 48 other states have had to take action in the 2003 biennium to balance their budgets due to declining revenues. Montana was one of the more mildly affected in the wake of terrorist attacks and an economic recession. The primary factors contributing to the shortfall are discussed below, along with a comparison to other states.

Capital Gains

Capital gains income represents the net income from the sale of assets such as land and equities. Over a several year period, equity values have risen dramatically, and the state has seen net capital gains income become a significant portion of individual income tax revenues. Since these revenues have been gradually built into the state revenue base, a corresponding increase in the expenditure base has occurred. With the decline in the equity markets, however, there has been a dramatic decline in net capital gains income which results in a reduced individual income tax base. And what makes the problem worse is that even with an improved economy, the net capital gains income base is likely to be reduced to a new "benchmark" amount. Since this equates to a reduced tax base, the state will have to find ways to replace those revenues or reduce state services.

Recession

The country entered an economic slowdown in March 2001 that was exacerbated by the terrorist attacks of September 11. Several economic assumptions adopted by the 57th Legislature showed progressive weakening, particularly in the latter part of fiscal 2002. As an example, the federal discount rate went from 6.0 percent in February 2001 to less than 1.0 percent in early 2002. The Standard and Poore's stock index has experienced an over 40 percent decline. Several of the state's major industrial facilities have faced a variety of challenges including energy prices and regulation, and several have faced bankruptcy or temporary shutdowns. Montana generally survived the recession with minimal impact, yet it has taken a toll on state revenues. Wage growth appears to remain moderate but net capital gains and investment income are presumed to be declining. And while the U.S. recession is officially over, the impacts are just being felt in state revenue collections due to the time lag between the impacts of economic changes and when tax revenues are actually received.

Federal Initiatives – Economic Recovery Stimulus Act

An external impact on state revenues that is a by-product of the economic recession and September 11 terrorist acts is the passage of the economic stimulus act by Congress. It is estimated by the Department of Revenue that this act will reduce revenues by over $16 million in the 2003 biennium. This act provides for accelerated depreciation of business equipment purchases as an incentive to buy new equipment. Because Montana tax code automatically adjusts for changes in federal tax laws, state individual and corporate income tax revenues will decline. At least seven states have enacted legislation to de-couple from the accelerated depreciation impact as part of their solutions to budget shortfalls.

Comparison with other States

Although there is a brightening of the overall economic picture, states are struggling with large budget deficits. Only two states are reporting collections that are at or above official state revenue forecasts. All other states are below budgeted targets and have had to address a budget shortfall, including a dozen states where tax collections are below official forecasts by over 10 percent. In April in particular, states collected over 20 percent less in income tax revenues during the year's most important month of collections, as compared to last year. Estimated tax payments, which are an indicator of anticipated receipts in the year ahead, are running over 25 percent behind in the first four months of 2001 (Montana's were down by 14 percent). Further, individual income tax refunds in the first four months of 2002 were nearly 15 percent above 2001 refunds (Montana refunds were up 36 percent). The magnitude of the revenue shortfalls is somewhat puzzling in view of only a mild recession, and while a drop-off in net

capital gains income is considered to be a major culprit, states will not be able to assess the precise causes until individual income tax returns can be analyzed. (The numbers used in the above comparison are from a report on income tax collections by the National Conference of State Legislatures and other organizations.)

Lower revenues are the major reason for state budget difficulties, but spending pressures are also contributing to the problem. Health care costs are growing at a double digit rate due to inflation, an aging population, and increasing prescription drug costs. Education and corrections budget demands continue to apply budget pressures. Even prior to dealing with a budget deficit, Montana was reducing services and associated costs in human services budgets just to stay within appropriated amounts.

LEGISLATIVE OPTIONS – ALTERNATIVES TO EXECUTIVE PLAN

INTRODUCTION

This section presents different broad categories of spending, revenue, and hybrid options that could be considered to address a budget shortfall, and in particular, budget prioritization. The figure shown below lists the broad categories that are discussed in more detail in the tables that follow. For many of these broad categories, one or more specific options are provided. You might see some redundancy with the executive plan in some of the more global concepts, as these are often items identified when budgets get tight. In addition, you will see that for some broad categories, no specific option is provided. Some items could not be included because of time constraints and may be developed further for consideration during the 2003 session.

Categories of Budget Balancer Options
Program Eliminations/Modifications Suspension of Cost of Living/Inflation Increases Spending Deferrals Funding Shifts Program Improvements/Efficiencies/Economy Tax Expenditures Increase Fees Broaden Tax Bases/Raising Tax Rates Temporary Revenue Enhancements Deferring Tax Incentives/Reductions Fund Balance Transfers Improved Tax Compliance/Collections Asset Sales

This represents a "shopping list" of various <u>options</u> for legislative consideration. It is not intended to be all encompassing, nor does it in any way represent staff recommendations. Staff has analyzed the merits/feasibility of these proposals only in a cursory manner. Estimates are included for potential savings where possible primarily to show a magnitude of savings. This brief analysis assesses some or all of the following:

- viability of each option,
- actions necessary to implement the option (statute change, rule change, etc.),
- cost of implementation,
- potential savings (general fund), and
- implications or impacts of the change, including numbers of people affected (individuals served and FTE eliminated).

The goal in preparing this section is to provide the legislature with a broad range of choices given the shortfall in state general fund revenue. Most of the listed items would not even be suggested in better fiscal times, but for the immediate future, there is a need to look deeper and to consider all options. Regardless of how the items listed are viewed by any particular individual or group, or embraced by the legislature, they should generate much thought toward what it will take to solve a growing budget shortfall.

PROGRAM ELIMINATIONS/MODIFICATIONS

This category of options assumes that there are programs that the state as a whole can live without, knowing full well that there are negative consequences for all options and there is always a constituency group that strongly supports a program. It is not inferred that these programs are without merit. The focus should be on reviewing whether programs still serve a clear purpose, achieve their objectives, are cost effective, or are providing duplicative services. Even when a program satisfies these criteria, it might

come down to assessing relative priorities, comparing perhaps the value or cost effectiveness of a human services program relative to an economic development program versus a regulatory program. Identifying such programs is always a daunting task for legislators and staff. To determine whether these are viable reductions, the legislature must consider overall state policy relative to the entire budget and available revenues.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Non-Statutory or Elective Programs	Eliminate Displaced Homemakers Program – Serves relatively small (approx 100) population – services not mandated. Total fiscal 2003 appropriation is $237,908. Governor Martz ordered reduction in fiscal 2003 expenditures of $18,423. Estimated fiscal 2003 savings based on 10 months of amount remaining for expenditure.	$183,000	$476,000
	Eliminate Job Registry Program – Serves small population (average of 14 ex-employees on registry per quarter), limited success (2 employees from registry re-hired into state government in fiscal 2002), and high cost ($18,500) per successful re-hire. Services are mandated under Employee Protection Act; legislative action would be required to eliminate the program. Total fiscal 2003 appropriation is $37,144. Governor Martz ordered reduction in fiscal 2003 expenditures of $21,143. Estimated fiscal 2003 savings based on 10 months of amount remaining for expenditure.	$13,000	$76,000
	Eliminate National Guard Scholarship Program – Program is non-mandated; additionally, the direct impact on recruiting/retention is hard to identify. Program received a $250,000 appropriation for the 2003 biennium. Estimated fiscal 2003 savings based on amount remaining unobligated to individuals.	Less than $100,000	$250,000
	Eliminate National Guard Youth Challenge Program – Program is non-mandated, with a relatively high cost ($5,600 GF, $14,000 total funds) per targeted graduate. Total fiscal 2003 appropriation is approximately $2.8M ($1.1M GF). Governor Martz ordered reduction in fiscal 2003 expenditures of $34,803. Estimated fiscal 2003 savings based on 10 months of amount remaining for expenditure.	$920,000	$2,240,000
General Fund Statutory Appropriations and Transfers	Statutory appropriations from the general fund for fiscal 2003 total $134.8 million. Some of these appropriations are addressed in other categories under this "Legislative Options" section. Others, such as funds for debt service cannot be considered. While there may be other options among the statutory appropriations that might be reviewed, they could not be explored in time for this report.	To be determined	To be determined

SUSPENSION OF COST OF LIVING/INFLATION INCREASES

There are a variety of increases currently statutorily slated to occur during fiscal 2003. The following table identifies and discusses options for reducing or eliminating some of these increases. It is important to recognize up front that while these may provide relief to the state budget crisis, these options would most likely have economic impact on the individuals or entities that are impacted.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Suspend Employee Pay Raises	The majority of authorized pay raises (nearly 7,000 employees) are covered by collective bargaining agreements that would likely need to be renegotiated. Rescinding pay raises for only non-covered employees would be deemed unfair. An alternative to rescinding pay raises might be to take the funding away (proposed by the Executive as a 20 percent reduction in the pay plan increase), however, this would result in the need for increasing vacancy saving from about 4 percent to about 8 percent, in addition to other cuts that an agency may have had to apply. It would likely cause forced vacancy savings as agencies keep positions open longer or reduce their workforce through reductions in force or furloughs.	Up to $7.2 million	Up to $19.2 million
Suspend Provider Rate Increases	Provider rate increases in DPHHS for fiscal 2003 were approved at $8.4 million general fund and $21.3 million other funds. Some provider rate increases have already been reduced. At this time, $8.2 million in general fund is provided for fiscal 2003, only $3.3 million of which are actually 2003 increases. If the 2003 rate increases were suspended through fiscal 2005, the 2005 biennium general fund savings would approximate $6.6 million. As an alternative, the legislature could suspend only a portion of the increase. For further detail, see the "Other Issues" discussion on page 25.	Up to $3.3 million	Up to $6.6 million
Suspend Inflation Rate Adjustments in Budget Process	This item would be applicable to the 2003 legislative session.	Not applicable	To be determined
Suspend Inflation Rate on HB 124 Distributions to Local Government	Suspend growth for entitlements and grants for fiscal 2003 through fiscal 2005.	$2.7 million	$9.1 million
Suspend BASE Aid Increases	Eliminating the 2003 BASE Aid increase will save the state $8.1 million in fiscal 2003, and $15.9 million in the 2005 biennium	$8.1 million	$15.9 million

Spending Deferrals

With some exceptions, options that defer spending shift workload to other workers or spending to a later year. However, in times of revenue shortfalls, these are a common consideration. Recognize, however, that these generally represent short-term solutions and that eventually the expense may be necessary.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Postpone Some or all Capital Projects	In addition to the Governor's proposal (see HB 10) which includes savings ($644,000) for reduction of six projects in the Long Range Building Program's "cash program", there are five other projects that might be considered. Of the nine projects approved in the fifty-seventh session for the "bond program", seven have already received partial funding from the July 2002 bond issue. In three of these cases, the UM chemistry building renovation, the HVAC systems upgrade at MSUN Cowan Hall, and the MSU agricultural experiment stations, continued work could be postponed temporarily (delaying costs of $1.3 million), although the completion costs would rise with inflation. The two projects where bonded funding has not yet been issued, the Dillion armory and the MSUN Applied Tech Center, could be postponed (delaying costs of $0.3 million). To date, appointments for the planning phase have been made. The Applied Tech project has received some of the federal funds requested for the project. In the case of the five projects mentioned, the bonds for funding, either continuation or start up of the project, are not scheduled for issue until fiscal 2003. As such, there would not be any debt service savings in fiscal 2003. The estimates for savings in the 2005 biennium are equal to the debt service associated with the bond issues. The debt service was calculated using an interest rate of 5.0 percent over a 20-year period.	$644,000 in executive proposal	$1.6 million
Postpone Some or all Economic Development Programs	This proposal would defer expenditures in some or all economic development programs, including Growth Through Agriculture (GTA), Board of Research and Commercialization (R&C), and programs within the Business Resources Division (BRD) in the Department of Commerce. Statutory Changes would be needed to eliminate statutory appropriations. This item is partially addressed in the Governor's proposal; specifically, reductions are proposed for Growth Through Agriculture and for the Board of Research and Commercialization.	GTA (statutory) - $1.25M R&C (statutory) - $4.85M BRD (statutory) - $1.1M BRD (HB2/13) - $1.25M	GTA (statutory) - $2.5M R&C (statutory) - $9.7M BRD (statutory) - $2.2M BRD (HB2/13) - $2.5M
	Governor's Office of Economic Development - Fiscal 2003 appropriations include $850,000 general fund in HB 2 and a statutory appropriation of $350,000 in SB 445. Governor Martz ordered reduction to the statutory appropriation in fiscal 2003 expenditures of $127,500. Estimated fiscal 2003 savings from the HB 2 appropriation is based on 10 months of amount remaining for expenditure.	Up to $222,500 (statutory) and $708,000 HB2	Up to $700,000 (statutory) and $1,700,000 HB2

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Statewide Hiring Freeze	This item would require that agencies not hire replacements for positions that become vacant unless an exception is allowed. One exception might be the exclusion of positions that require 24/7 coverage. There is no way to anticipate vacancies. However, using an average annual cost per position (including insurance) of \$39,000, the savings for 100 positions vacant for ¼ of a year would be \$975,000 per year. If the freeze remains in place into subsequent years, the savings would grow considerably. There would undoubtedly be a limit as to how long a freeze could continue without crippling programs.	\$975,000 per 100 positions assuming vacancy for ¼ year	Unknown if hiring freeze would continue into next biennium
Employee Furloughs	Assuming an average annual cost per employee of \$35,100 (excluding health insurance), the hourly calculation would be \$16.875. A one-day furlough of one employee would average \$135 in savings. There are an estimated 4,500 positions funded from the general fund (excluding U-System but including "critical" positions which have not been defined yet).	\$135,000 per furlough day per 1000 employees	\$135,000 per furlough day per 1000 employees
Moratorium or Reduction of Certain Categories of Expenditures, Such as Contracted Services, Travel, Equipment, Subscriptions, Etc.	This item could be implemented in many ways. One state, for example, placed a moratorium on professional/technical services contracts. Besides a cut in 2003 amounts, it stipulated that agencies could not enter into new contracts or renew existing contracts, although the Governor could approve exceptions such as a contract necessary to avoid disruption of critical services. Another state placed a moratorium on out-of-state travel. Again, exceptions can be approved. NOTE: The 2001 legislature reduced general fund travel by 25 percent. Fiscal 2002 travel expenditures reflect that action and fiscal 2003 expenditures are expected to show the same reduction. Further reductions in 2003 not identified.	Savings would vary based on proposals	Savings would vary based on proposals

FUNDING SHIFTS

These options would include shifting funding from the general fund to other sources such as fees, federal/local governments, or the private sector. It occurs in good economic times as well as bad times because in many instances it makes sense to have the beneficiary of services pay for the services. Most of these however, represent policy changes that cut to the core of philosophical views concerning the obligations of state government as an employer or the role of the legislature as policy makers.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Reduce State Contributions for Employee Health Benefits	Insurance contributions by the state are included in the pay plan and are in negotiated collective bargaining agreements for about 7,000 employees. The contributions are currently set at \$366 per month for 2003. Assuming about 11,000 employees enrolled in health insurance plans, and a \$10 per month reduction, the savings would be \$1.3 million. Assuming 37 percent is GF, the savings would be \$480,000 GF.	\$480,000 per \$10 per month reduction in state contribution.	\$960,000 per \$10 per month reduction in state contribution.
Maximize the Use of SWCAP/SFCAP	The Statewide Cost Allocation Plan (SWCAP) and the State Fund Cost Allocation Plan (SFCAP) provide for the allocation of costs of centralized administrative functions to the various state agencies. Periodically, these plans are reviewed to determining accuracy and fairness. A review prior to the 2003 session could be completed to ensure that the plans are maximizing revenues from non-general fund sources.	Not applicable	Unknown at this time

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Reduce State Support for Higher Education/Shift to Student Tuition or Other University Funds	The legislature may wish to further reduce general fund support to higher education. As has occurred in recent months, the Board of Regents might respond with an increase in tuition to partially offset the general fund reduction and to maintain services at a desired level. The Board might also consider using other fund sources in some instance. Regardless of the approach, reduction in general fund support would likely shift costs to other funding sources.	The amount of savings to the general fund would be the amount of the reduction	The amount of savings to the general fund would be the amount of the reduction
Reduce State Support of Historic Preservation Programs	This option would eliminate accommodations tax funding for the Montana Heritage Commission-Virginia/Nevada City and free it up for other uses. The 55th Legislature appropriated nearly $9,400,000 for the purchase and restoration of the buildings and artifacts in Virginia City and Nevada City and established the Montana Heritage Commission to manage the two sites. A $400,000 (less $45,000 transfer for Fort Peck Interpretive Center) annual deposit from the accommodations tax into the MT heritage and preservation development account through fiscal year 2001 was included in the initial legislation. Legislative intent at establishment was that the properties become self-supporting. SB 263 passed by the 57th Legislature continued the $400,000 (less $45,000 transfer for Fort Peck Interpretive Center) annual deposit of the accommodations tax into the MT heritage and preservation development account for fiscal years 2001 thru 2006. Statutory changes would be necessary to implement.	Up to $400,000	Up to $800,000
Refinancing General Fund Expenditures with Federal Funds	The Legislative Fiscal Division, in reports to the Legislative Finance Committee, has identified four potential refinancing schemes that could reduce general fund expenditures while maintaining or potentially expanding services by increasing federal funds. These options relate to "foster children as a case management target group", the "community collaboration project", "intergovernmental transfers", and "federal CHIP funds". A more detailed discussion of these options is in the "Other Issues" section on page 25.	Would have to be determined	Would have to be determined
Divert Cash Flows from the Coal Tax Trust/Subtrusts	Moneys currently flowing from the coal trust income goes to the Treasure State Endowment Program state special revenue accounts to fund various projects. The legislature could redirect some of those funds to the general fund.	Depends on what amounts remain uncommitted	Up to $15 million
Divert Future Cash Flows from the Tobacco Trust	Moneys currently flowing from the tobacco trust income goes to the tobacco settlement state special revenue accounts to fund various projects. The legislature could redirect some of those funds to the general fund. This means that existing programs or services funded from this source would need to be discontinued while the funds are used to fund other health care related programs, thus freeing up general fund.	Would have to be determined	Would have to be determined

PROGRAM IMPROVEMENTS/EFFICIENCIES/ECONOMY

These options include seeking ways to provide the same services at lower cost, economies of scale, improved coordination, and prioritization. Ideally, this is an ongoing activity. Indeed, many of the items listed below have been discussed in the past. In times of revenue shortfalls and an ensuing budget crisis, we are compelled to look at them again.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Consolidate Programs	This item would be reviewed for the 2003 legislative session.	Not applicable	Unknown at this time.
Agency Restructuring or Consolidation	This item would be reviewed for the 2003 legislative session.	Not applicable	Unknown at this time.
Consolidate School Districts	This item would be reviewed for the 2003 legislative session.	Not applicable	Unknown at this time.
Statewide Employee Reduction in Force	Reductions in funding for personal services are a prerogative of the legislature. If only funding is affected, there is a risk of program constituents suing the state because a statutory mandate is not being met. Reductions in force should be accompanied by elimination of those mandates that can be directly tied to the reduction.	Legislature would determine.	Legislature would determine.
Retirement Incentives/Early Retirement Legislation	Historically, the legislature has enacted legislation that encourages retirement of higher cost employees (because of longevity) in state government. Since most of such positions are refilled with other employees, the generated cost savings is to a degree shifted to lower cost positions in which new employees are hired. There is an initial cost to agencies in implementing early retirement legislation including costs of the state share of buying additional time and payouts of sick and annual leave. While savings may occur, it is difficult to determine how much savings really occurs. In addition, there is a risk of accelerating the loss of some of the most valuable employees, as there is a drain of experience and institutional memory from state programs. Many of the retirees may have retired regardless of the incentives offered. An aging workforce means that retirement is in the future of many employees.	Unknown	Unknown
Change Laws Requiring Incarceration	Department of Corrections – Due to budget constraints a number of states are re-examining sentencing, which has resulted in the repeal of mandatory minimum sentences for some nonviolent offenses. This option would require time to develop and may be considered for the 2005 biennial budget. (The department will propose a change to statute allowing conditional early release if capacity or budgetary limits are met. The early release proposal will be brought forward to stay within the fiscal 2003 appropriation and avoid a supplemental.)	There will be a proposal to avoid supplemental for fiscal 2003	To be determined
Explore Privatization Efficiencies	This item requires time to develop proposals. Consider for 2004-05 budget process.	Not applicable	To be determined
Increase Central Management of Information Technology Projects	This item would be reviewed for the 2003 legislative session.	Not applicable	To be determined

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Reduce Rural Outreach Driver Licensing Stations	Dept. of Justice Motor Vehicle Division - Reduce the number of rural outreach stations and increase the services at the full-service offices. Individuals may have to travel up to 90 miles one way for services, but most individuals are issued a driver's license that is valid for eight years, thereby keeping the inconvenience to once every eight years. (If the executive proposal to replace general fund with highways state special revenue is passed by the legislature, this proposal would not have a general fund savings in fiscal 2003.)	$77,231	$156,000
Cap Reimbursement Rate	Cap daily rate for reimbursement of prisoner per diem to county jails. Currently jail contract costs range from $21/day to $86/day. Change statute to define a capped amount for reimbursement and put language in HB 2 stating that due to budget shortfalls, prisoner per diem reimbursement to county jails in fiscal 2003 will not exceed $45/day. Savings will result in the departments of Corrections and Justice. Highway Patrol changed procedure due to 17-7-140 reductions where fewer individuals will be detained in jail. This could increase potential savings.	$46,400 (Justice) $141,370 (DOC)	$403,700 (Justice) $707,120 (DOC)

TAX EXPENDITURES

This category of options involves examining whether tax deductions/incentives achieve their objectives/effectiveness, or determining how they measure up compared to other priorities of state and local government.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Decouple from Federal Accelerated Depreciation Incentive (Economic Stimulus Act)	There are many methods that states have used to decouple from the bonus depreciation provision of the Job Creation and Workers Assistance Act. Some methods increase state revenues in absolute terms, while others hold state revenues at pre-September 11, 2002 levels. To provide the equity for all and ease of applicability, Montana might add a specific date to the MCA in respect to depreciation. Title 15, Section 31, part 114, would be amended to say, "The [depreciation] allowance is determined according to the provisions of section 167 of the Internal Revenue code ~~in effect~~ with respect to ~~the taxable year~~ September 10, 2001." Estimates are based upon Department of revenue numbers. The state could choose to make the adjustment to code retroactive. If this were done, further adjustments would be necessary to add back the effects on Montana revenues from fiscal 2002.	$10,102,259 $5,972,130	$5,580,139
Eliminate Inflation Rate on HB 124 Distributions to Local Government	Eliminate growth for entitlements and block grants, making the growth a negotiable item. Local government and state would have to negotiate inflationary growth rate.	Up to $2.7 million	Up to $9.1 million
Reduce Distributions to Local Government (HB 124)	Reduce entitlements and block grants by 10 percent.	$14.8 million	$29.6 million

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Eliminate Previously Enacted Tax Deductions/ Incentives	Repeal mineral royalty payments to local governments (HB 226 of 2001 session). The executive proposal includes a revision to distributions that directs $740,000 to the general fund in fiscal 2003. To the extent that additional funds are received that exceed the thresholds in the law, further redistributions could be considered. As of the printing of this report, additional funds had not been identified.	To be determined	To be determined
	Property tax - Eliminate SB 417 (1995) business equipment tax deductions	$7.5 million	$8.8 million
	Property tax – Eliminate tax increment financing districts	$2.9 million	$5.8 million

INCREASE FEES

It is common to look to existing or new fees as a solution to a revenue shortfall. The question to ask is whether or not a fee is adequate for the services provided or required, or whether, for example, the state general fund recoups the costs of loaning moneys that would otherwise be earning interest for the general fund.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Charge Interest on General Fund Loans within the State Treasury	At the end of FY 2001, there were 38 general fund loans outstanding for a total of $55.3 million. Most of these loans were to DPHHS for federal programs that operate on a cash reimbursement basis. Some of these programs (about $30.1 million) are subject to the Cash Management Improvement Act, which means we already recoup interest if DPHHS is drawing correctly. Potential interest earnings are difficult to estimate. In FY01, the Short-Term Investment Program averaged 6.35 percent. In FY02 the average to date is 3.04 percent. Agencies generally keep these loans for a full year (because statute allows it) although there are some exceptions. Charging interest might improve their cash management practices which would benefit the general fund by itself. For each $1 million loaned at 3.04 percent for one year, the interest earned for the general fund would be $30,400. For 2001, the amount of principle subject to this concept might have been as high as $25 million for a revenue gain of $760,000. Further review is necessary to determine the potential amount that might be subject to interest charges.	$30,400 per $1M loaned for 1 year	$30,400 per $1M loaned for 1 year
Increase Court Fees	This item would apply an across the board percentage increase to all district court fees. Under current law various fees are collected by county governments and deposited in the state general fund in support of district court operations. It is estimated that the state would receive $1,940,363 from these revenue sources in fiscal year 2003. Fee increases have been modest over the past 10 years consisting of approximately one fourth of the fees having increased since 1991 by an average of $25 per increased fee. In addition, 4 new fees were added in 1997. Increasing fees would require an amendment to statute. Costs of implementation would be minimal since counties are already collecting fees. Increasing only select fees may be more feasible but would require additional time to complete the analysis.	$19,400 per 1% increase in all fees	$194,000 per year assuming 10% across the board increase
Increase Gambling	Department of Justice – Change statute to allow sufficient state special revenue to replace general fund in the division. See	$342,000	$760,000

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Control Permit Fees	Gambling License Fee Account issue on Page 26.		
Establish Child Support Enforcement Fees	One option the legislature could consider that could decrease the general fund deficit is to charge fees to non-welfare clients that utilize services provided by the Child Support Enforcement Division (CSED) of the Department of Public Health and Human Services (DPHHS). Federal mandates require that child support enforcement services be provided to anyone who applies for the services. However, it is possible to recover all or a portion of the cost of these services by charging non-welfare users fees for this service. Based upon previous experience, and assuming a fee can be implemented for 10 months of fiscal 2003, the estimated GF revenue gain would be $344,000.	$344,000	$826,000
Increase State Park Fees	The Parks program within the Department of Fish, Wildlife, and Parks (FWP) received a $279,255 general fund appropriation in fiscal 2003. This funding is primarily used for on-going maintenance efforts in the state park system. An alternative to utilizing general fund for these purposes would be to raise fees in several of the more popular state parks. According to FWP, eliminating senior discounts; increasing Smith River, camping, Lewis and Clark Caverns, and parks passports fees; and implementing fees for primitive parks are among the increases that would have potential to offset the loss of general fund. The increased revenue generated from these fee increases could be used to replace general fund on a dollar for dollar basis.	$110,250	$630,000
Establish Fees to Fund the Office of Consumer Affairs	Fund the Office of Consumer Affairs in the Department of Administration with fees (new) paid by those industries currently required to register or which have a high incident of consumer complaint. The fees would be established at a level adequate to replace general fund support of the program and with state special revenue derived from fee revenue. This alternative funding proposal would not be needed for fiscal 2003 since a funding switch from general fund to state special revenue was part of the Governor's 17-7-140, MCA, general fund spending reduction plan with state special revenue coming from fund balance of a fund without regular and predictable revenue sources. Special session establishment of the fees would establish a fund balance that could be used during the 2005 biennium to fund the office.	$0	$533,000

Broadening Tax Bases/Raising Tax Rates

Tax increases are an obvious, although not popular, option for reacting to a revenue shortfall. The following are some options suggested for consideration. In one case, the option provides revenues that can in turn be used to capture additional federal funds for human resource programs. The options listed for increasing certain taxes are only a sample of potential increases, with the main purpose being to demonstrate the magnitude of revenue that might be generated.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Adopt Gross Proceeds Tax on Health Care Providers	The Department of Public Health and Human Services (DPHHS) is exploring the feasibility of imposing a gross proceeds tax on medical providers to fund part of the state match for Medicaid program expenditures. During the 2003	To be determined	To be determined

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
	biennium, the state match for Medicaid eligible services is about 28 percent and the federal share is 72 percent. Federal Medicaid regulations allow states to impose medical provider taxes to use as state matching funds. However, any tax must be broad-based meaning that all providers within a class of medical providers must pay the tax. It is not permissible to only tax those providers who participate in the Medicaid program or those with a certain percentage of Medicaid clientele. An example of such a tax is the nursing home utilization fee of $2.80 per bed day that was enacted in 1991 (section 15-60-102, MCA). While the concept of the tax is simple, the design is not. For instance, how would gross proceeds be defined? Would it be total income or would certain deductions be allowed? If certain providers did not want to be included, how would business relationships between included and excluded providers be considered in calculation of gross proceeds? What would the tax rate be? What would the tax proceeds be used for? DPHHS is in the initial stage of the project. It recently hired a project director to meet with different medical groups to develop a cooperative proposal to the 2003 legislature if providers are interested.		
Increase Selected Taxes	Income tax - Eliminate all credits, except out-of-state	$7.0 million	$14.0 million
	Property tax – Increase statewide mill by 1 mill	$1.8 million	$3.6 million
	Property tax – Raise tax rate on business equipment to 4 percent, adjust HB 124 payments down	$17.3 million	$34.6 million
	Sales taxes – Rental car tax of 8 percent	$2.5 million	$6.8 million
	Sumptuary taxes - Raise beer tax by $1	$0.7 million	$1.9 million
	Sumptuary taxes - Raise wine tax by 10 cents	$0.6 million	$1.5 million
	Sumptuary taxes - Raise liquor tax to 36 percent from 26 percent	$0.5 million	$1.4 million
	Sumptuary taxes - Raise cigarette tax by 10 cents	$4.9 million	$13.0 million
	Sumptuary taxes - Raise video gambling tax to 25 percent from 15 percent	$22.5 million	$60.0 million
Restructure Tax Base	One option would be to change how recreational vehicles are taxed in Montana. Currently, taxes are basically a flat fee (in lieu of tax) based on vehicle age. A change to tax them on value would generate a sizable increase in revenue if structured in a manner similar to other vehicle taxation. Unfortunately, at this time, there is no data available on the value of recreational vehicles to be used for revenue estimates.	Unknown	Unknown
Tourism Tax	Double bed tax from 4 percent to 8 percent	$9.8 million	$27.9 million

Temporary Revenue Enhancements

In past years, the legislature has enacted temporary tax increases to deal with revenue shortfalls. These are short-term fixes, but can see the state through to better times.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Tax Surcharge	Income tax – 1 percent surtax	$5.2 million	$10.4 million

	Natural resource taxes – Surtax of 10 percent on oil and gas production (all to general fund)	$4.7 million	$9.4 million
	Natural resource tax – Surtax of 10 percent on metal mines (all to general fund)	$0.8 million	$1.6 million
	Natural resource tax – Surtax of 10 percent on coal severance (50 percent to general fund)	$1.7 million	$3.4 million
	Natural resource taxes – Double wholesale energy and electrical energy tax	$8.3 million	$16.5 million
	Property tax – Surtax of 10 percent on motor vehicles (light)	$5.3 million	$14.0 million

DEFERRING TAX INCENTIVES/REDUCTIONS

Reversing actions that allowed individuals or entities to pay less taxes (for example, as an incentive for business startup or expansion) can allow moneys that would not otherwise reach the general fund to be recouped. To the extent that such incentives might have benefited the state or local economy, the benefits would be potentially delayed or lost.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Defer Impacts of Recent Tax Incentive/Reduction Bills	Potential options under this item, if identified, will be reviewed and developed for the 2003 session. There was not enough time to identify options for this publication.	Unknown	Unknown

FUND BALANCE TRANSFERS

Some states in response to the current budget crises, and this state in the past, have transferred moneys from other state accounts to enhance the general fund balance. This has been viewed as appropriate particularly in instances in which fee revenue has outpaced the program costs or general fund priorities rank higher than the other fund program priorities. The following are some options that the legislature might consider.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Transfer Funds from Tobacco Trust Fund (with some restrictions, must be used for healthcare related expenditures)	Transfer of money from the tobacco trust would require a two-thirds vote of the legislature. The fund balance in the trust is approximately $23.2 million. The constitution provides for limits on how the moneys can be used.	Up to $23.2 million in trust	
Transfer Funds for Coal Tax Trust/Subtrusts	Transfer of money from the coal tax trust funds requires a three-quarter vote of the legislature. The balance in the Permanent Trust, the Treasure State Endowment Trust, and the Regional Water System Trust totals approximately $650 million.	Up to $650 million in trust	
Transfer Funds Going into Shared Account	The executive proposal reduces the amount of funds going to the Shared Account by one-half. The remaining half continues to fund various programs and services, and could be reduced further.	Up to $4.8 million	
General De-earmarking Effort/Transfer of Fund Balances	Public Service Regulation – Change statute to allow amounts in the Montana Universal Access program account in excess of a determined dollar amount (i.e. $100,000) to be transferred to the general fund. The revenues to this fund were a surcharge based on retail revenue for all intrastate telecommunication services in Montana. Statute currently requires funds to be used to provide discounted advanced services to eligible users. Negligible amounts of the fund have been used for its intended purpose.	$500,000	$0

IMPROVED TAX COMPLIANCE/COLLECTIONS

State revenues can often times be enhanced through efforts that seek to ensure taxpayer compliance with tax code. Increased audit efforts, for example, can result in additional revenues.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Increase Audit Activity on Non-compliant Taxpayers	Based on information provided by the Department of Revenue, it is estimated that general fund could be increased by nearly $197,000 per year by adding auditors to focus on high-risk areas of individual income tax compliance. It is estimated that each auditor would increase general fund collections by an average of $250,000 per year once trained and functioning in the field. With a cost of roughly $53,000 per year, the state would see a nearly five fold return on the dollars spent hiring the auditors. If additional auditors were authorized in fiscal 2003, the delayed implementation would result in only a $12,500 net revenue increase per auditor in fiscal 2003, but the full net revenue increase of $197,000 could be expected in fiscal 2004 and subsequent fiscal years for each auditor. Caution would be advised in relying too heavily on increasing auditor staff to maintain a high level of return on investment, as one could expect diminished returns.	$12,500 per additional auditor	$394,000 per additional auditor

ASSET SALES

The legislature can consider the sale of current or potential assets as a means of raising additional revenues. This is, however, a short-term solution to the revenue shortfall that can have long-term adverse impacts to future revenues. It is an option for getting through the tough times that some states have chosen.

Item	Item Descriptions	Fiscal 2003 GF Savings	2005 Biennium GF Savings
Sale of Future Revenue Streams	Some states have sold future tobacco settlement revenues for a fixed amount, with the proceeds to be used to help balance their state budget. Constitutional restriction would make this more complicated for Montana but it is expected that there is a level of future revenue for which this might be possible. There has not been sufficient time to research this option so an estimate is not available. It might be an option for the 2005 biennium.	Unknown	Unknown

OTHER ISSUES

Developmental Disability Services – Income Eligibility Criteria

The 2001 legislature through House Bill 2 directed the Department of Public Health and Human Services (DPHHS), Disability Services Division (DSD) to complete a report on the impact of applying income criteria to determine eligibility for developmental disability services and benefits. DSD provided their report, based upon a point in time survey of recipients of developmental disability services that were not currently Medicaid eligible, to the Legislative Fiscal Division in late June 2002. There is much analysis to be completed and the data included in this report is based upon an initial review of the DSD report.

Of the non-Medicaid children and families receiving developmental disabilities services about 16 percent reported having an income at or below 100 percent of the federal poverty level. The 16 percent of the clients at or below 100 percent of the federal poverty level received service dollars totaling almost 17 percent ($0.7 million) of the $4.5 million of services provided. These services are funded by a combination of state general fund, federal Individuals with Disabilities Education Act, Part C funds and Medicaid funds. Among non-Medicaid eligible adults receiving developmental disabilities services, 22 percent reported having incomes at or below 100 percent of poverty. The clients reporting incomes at or below 100 percent of the federal poverty level utilized almost 22 percent ($0.9 million) of the $4.1 million of services provided to those surveyed.

Conversely, this indicates that 84 percent of the non-Medicaid eligible clients receiving children and family services reported incomes above the federal poverty level (or did not respond to the survey) and that the value of services provided to these clients was about $3.8 million total funds. In adult services, 78 percent of the non-Medicaid eligible clients reported incomes above the federal poverty level (or did not respond to the survey) and the value of services provided to these individuals totaled about $3.2 million total funds. Given that more than 75 percent of the non-Medicaid eligible clients receiving developmental disability services reported incomes greater than the federal poverty level, the legislature may wish to pursue options that require these individuals to contribute to the costs of their care and that establish income eligibility criteria for those receiving publicly funded developmental disability services. Currently, all those in need of services are eligible to receive services regardless of income level.

Additionally, the report indicated that some individuals that were not currently Medicaid eligible may not have applied for or had Medicaid eligibility determined for a number of reasons. As previously stated there is much analysis of this issue yet to be completed. However, an initial step that the legislature could direct the department to implement is the requirement that all clients apply for Medicaid prior to becoming eligible to receive developmental disability services. This action would provide assurance that all those eligible for the Medicaid program were using the program and that clients that could be funded with Medicaid funds were not being funded by other sources such as general fund. It is currently unclear to what extent other funding sources may be supporting clients that are eligible but have not applied for Medicaid.

Gambling License Fee Account

The legislature may want to change statute to allow sufficient state special revenue to be generated to replace general fund in the Gambling Control Division.

Background

In fiscal 2002, approximately $710.0 million was wagered on video gambling machines, with the average amount wagered per machine in Montana at $39,750. The average gross income per machine in fiscal 2002 was approximately $16,300[1]. After payouts, tax, and the $200 permit fee, each machine would average $13,655 annually.

Funding of the Division

The primary funding for the division is from revenues generated through licenses and permits for gambling operators, machines, and other gambling activities, as well as license fees for video gambling machine manufacturers/distributors. The revenues from the $200 machine permit fee are split 50/50 between local government and the gambling license state special revenue account. In addition, the division was appropriated general fund in the 2001 and 2003 biennia for the automated accounting and reporting system (AARS) and HB 2 language states legislative intent to continue the $380,000 general fund appropriation each year of the 2005 biennium and $236,250 each year of the 2007 biennium for this project. (The 1999 legislature made the decision to commit approximately $1.5 million in general fund monies to the Gambling Control Division for the AARS to replace gambling license funds that had been transferred to the general fund in 1993.)

Section 23-5-110(3), MCA states:

> "Revenue to fund the expense of administration and control of gambling as regulated by parts 1 through 8 of this chapter must be derived solely from fees, taxes, and penalties on gambling activities, except the gambling activities of the Montana state lottery and the pari-mutuel industry."

Because the function of the AARS is to facilitate the control of gambling, funding this function with general fund contradicts substantive law.

Gambling License Fee Account Stability

The gambling license fee account would have a shortfall of over $400,000 in fiscal 2003 if expenditures equal the amount appropriated. The division has made necessary management decisions so expenditures will be within revenue collected for the 2003 biennium. However, the department feels that continued operation at this restricted level could result in delays in processing applications and a slowdown in investigations and inspections. At the time of this report, the department projects a positive fund balance in the account. The numbers of machine permits issued have declined the last two years and are projected to decrease further in the 2005 biennium. This has not allowed revenues to keep up with appropriations and the fund balance is being depleted. With a flat or decreasing revenue source, a long-term solution is needed to fund the division. A change in the fees, distribution, or funding of the division will be needed to keep the fund solvent.

[1] Gross income is the amount of money put into a video gambling machine less prizes paid out.

Options

In addition to keeping the fund stable, the legislature may want to change statute so sufficient revenue is generated to replace general fund to bring the funding of the division into compliance with current law by: 1) increasing the permit fee to a level sufficient to maintain a positive balance and replace the general fund (each $10 increase would result in an increase of approximately $167,000 of which 50 percent would go to the state special revenue account); 2) changing the 50/50 distribution between local and state government; and/or 3) basing a portion of the funding on the video gambling machine gross income tax, which has continued to experience growth.

The division has reached a settlement with the contractor for the AARS and the $342,000 general fund appropriated for fiscal 2003 is committed to pay the contractor for the testing and installation of the AARS. Therefore, if general fund is reduced it must be replaced with another revenue source.

Ongoing? Yes. If statute is amended and state special revenues remain sufficient to fund the division at appropriated levels.

ACTIONS TAKEN BY OTHER STATES

INTRODUCTION

As of June, the National Conference of State Legislatures (NCSL) had indicated that up to 48 states and the District of Columbia reported budget shortfalls caused by either lower than anticipated revenues, or a combination of lower revenues and higher program costs, in fiscal 2003. In fiscal 2002, 43 states and the District of Columbia reported budget shortfalls. As a consequence, states have taken a variety of measures to meet budget shortfalls that are estimated from 0.9 percent to 31.0 percent, and up to $5.1 billion in fiscal 2002. The following table shows each state's percentage of shortfall in fiscal 2002.

Some states have already taken action or have action pending (either in regular or special session), while others are monitoring the situation or plan special sessions roughly concurrent with Montana's. Consequently, actions in fiscal 2003 are still fluid for many states. In addition, since fiscal 2003 revenues are still only projections, the situation could change radically for many states. Therefore, many of the actions discussed in this section should be considered works in progress. NCSL has been surveying states to update much of this information, and hopes for a July 23 publishing date.

Other States Budget Shortfalls
Fiscal 2002

State/Jurisdiction	Percent of FY 2002 General Fund Budget	State/Jurisdiction	Percent of FY 2002 General Fund Budget
Alabama	3.9%	Montana	4.6%
Alaska	31% - 33%	Nebraska	4.2% (biennium)
Arizona	13.0%	Nevada	6.2%
Arkansas	4.2%	New Hampshire	0.9%
California	6.5%	New Jersey	12.0%
Colorado	12.0%	New Mexico	1.8%
Connecticut	3.0%	New York	-
Delaware	-	North Carolina	8.3%
District of Columbia	5.0%	North Dakota	0.9%
Florida	6.6%	Ohio	2.0%
Georgia	4.8%	Oklahoma	8.3%
Hawaii	4.0%	Oregon	8.7% (biennium)
Idaho	7.6%	Pennsylvania	3.3%
Illinois	3.0%	Rhode Island	2.8%
Indiana	12.6%	South Carolina	6.5%
Iowa	4.1%	South Dakota	1.4%
Kansas	5.4%	Tennessee	5.2%
Kentucky	7.3%	Texas	-
Louisiana	-	Utah	6.7%*
Maine	2.3%	Vermont	2.5%
Maryland	4.1%	Virginia	10.0%
Massachusetts	4.0%	Washington	8.0%
Michigan	5.1%	West Virginia	-
Minnesota	1.6% (biennium)	Wisconsin	5% (biennium)
Mississippi	5.6%	Wyoming	-
Missouri	6.5%	Average**	6.0%

*Shortfall as a percentage of general and uniform school funds
**Of those states experiencing shortfalls
***Based upon the difference between revenues and estimates in fiscal 2002

INFORMATION SOURCES

The following information is from three sources:

1) NCSL published a report on April 16. (As stated, they will provide an update on July 23.) The report details the various types of reductions and other actions taken by states, but is not specific on the types of reductions.
2) National Association of State Budget Officers published a report in May. This report is generally less detailed than the NCSL report, but has more detail on revenue enhancements.
3) Individual reports from states. Generally states are reporting actions as part of regular fiscal reports. There are also some special session reports, and other reports that outline options for consideration.

(Please note that the information, particularly between NCSL and NASBO, is not always consistent.)

MEASURES USED BY OTHER STATES

Three general approaches are discernable:

1) States are tapping into reserve or rainy day funds (options not available to Montana other than the Coal Tax Trust), borrowing from dedicated (earmarked) funds, using ending fund balances, or transferring balances from other funds.
2) 22 states enacted tax increases in fiscal 2003 (as of April 16), while only 7 did so in fiscal 2002. Fee and/or tuition increases were enacted by 4 and 5 states, respectively.
3) While only 7 states indicated tax increases in fiscal 2002, 41 stated they had imposed budget reductions. At the same time, while the number of states imposing higher taxes in fiscal 2003 is 22, only 29 states reduced budgets. Some made reductions to targeted areas, while many enacted across-the-board cuts and/or other general reductions.

Due to the general nature of the information, and in some instances the requirement of budget adjustments during regular session, it is not possible except in certain circumstances to determine how much of a reduction was met by what means (for example, 50 percent is budget reductions, 40 percent is tapping of reserve funds, etc.). However, an extremely rough calculation made from existing NCSL information indicates that budget reductions are being used to address just under one-half of the shortages in fiscal 2002.

These options are generally listed without comment here. However, the discussion beginning on page 11 of this report listing and discussing potential options for legislative consideration applies Montana's situation to many of those employed or under consideration by other states.

1) Budget Reductions. Of 43 states and the District of Columbia in fiscal 2002, 41 have instituted some kind of budget reductions.

   Looking at individual reductions (when they are available) on individual state websites shows that states are generally:
   a) Taking across the board reductions, with or without exemptions such as education or human services. Although NASBO indicates 26 states have made across the board reductions, the information from NCSL either does not indicate this or cannot be used to make this inference. By our reckoning, 15 states can be confirmed as having made across the board cuts, with or without exempting certain functions (human services and education being cited as exceptions). Where information is available, the cuts range from 1 percent to 7 percent (Indiana). Most states appear to be in the 2.0 percent to 3.5 percent range. Governor Martz has already applied a reduction averaging 3.5 percent of eligible general fund expenditures.
   b) Eliminating non-mandatory functions. A check of information, when available, from several states shows that states are generally eliminating non-mandated services, but do not appear to be eliminating major programs. It is difficult to correlate these functions in general terms to those in Montana.

Other types of general reductions employed in other states that could be applicable to Montana include:

c) Hiring freeze (proposed by the executive). A number of states are proposing either a "hard" or a "soft" freeze.
d) Purchasing freeze (proposed by the executive). These freezes generally are targeted toward non-critical expenditures such as equipment and non-critical supplies.
e) Travel restrictions, including a moratorium on all out-of-state travel and most in-state travel not funded with non-state sources
f) Employee furloughs (proposed by the executive). Only Iowa is making furloughs in fiscal 2003. Staff in Iowa indicate that the six day furlough may be optional as part of a general reduction in personal services funding.

2) Tax Adjustments. NCSL reports that 7 states are employing tax enhancement measures in fiscal 2002, with 22 employing this option so far in fiscal 2003. Among the general categories applicable to Montana are the following:
   a) Cigarette. The following table shows states enacting cigarette taxes in 2002. Montana's cigarette tax is $0.18 per pack.
   b) Vehicle
   c) Gaming
   d) Increased compliance measures such as auditing
   e) Closing of various loopholes or exemptions
   f) Delay of the start of tax cuts or interruption of planned adjustments
   g) De-coupling from the federal economic stimulus package. So far Connecticut, the District of Columbia, Maryland, Massachusetts, Missouri, Rhode Island, Vermont, Wisconsin (awaiting Governor's signature as of this writing) have chosen to de-couple. As of this writing, New Jersey has the measure under consideration and New York passed legislation allowing New York City to de-couple.
   h) Tourism tax

Cigarette Tax Increases
2002

State	Per Pack Increase	Total Tax
Connecticut	$ 0.61	$1.11
Hawaii*	0.20	1.20
Illinois	0.40	0.98
Indiana	0.40	0.56
Kansas**	0.46	0.70
Lousiana	0.12	0.36
Maryland	0.34	1.00
Michigan	0.50	1.25
Nebraska	0.30	0.64
New Jersey	0.70	1.50
New York	1.42	1.50
Ohio	0.31	0.55
Pennsylvania	0.69	1.00
Rhode Island	0.32	1.32
Tennessee	0.07	0.20
Utah	0.18	0.70
Vermont***	0.49	0.93
Average	$ 0.44	

*To $1.40 on July 1, 2004
**To $0.79 on July 1, 2003
***To $1.19 on July 1, 2003

3) Fee Increases. Among the fee increases reported by states are:
   a) Court (e.g. criminal, civil, filing)
   b) Various vehicle and vehicle related (e.g. boats, snowmobiles, heavyweight truck)
   c) Department regulatory and environmental (e.g. water permit, pesticide, hazardous waste)
   d) Administrative
   e) Surcharges (e.g. 911, water, miscellaneous)
   f) Gaming
   g) Tuition

4) Other Measures. Among the options in this category are:
   a) Delay of building projects, or going from pay-as-you-go to debt. Montana may have some options to delay creation of debt on some projects.
   b) Borrowing from other funds (such as the Coal Tax Trust, or the Highways State Special Revenue Account).
   c) Increased county share of certain costs
   d) Gaming expansion (Montana may be in a reverse situation if states vote to allow Mexico into Powerball, as the Department of Commerce has indicated the state could no longer participate in an international game. We have not verified this information.)
   e) Shifting of funds to federal or state special revenue. One option presented by LFD staff was to have personnel in the Department of Public Health and Human Services devoted exclusively to looking at creative ways to leverage more federal funds in that agency.

EXECUTIVE PROPOSED BUDGET PLAN

OVERVIEW

This section provides a summary evaluation of the executive spending reduction plan. It also provides a summary view of the budget balancers proposed in the executive plan, intended to provide the reader with a general understanding of the major components of the reduction plan. It includes agency expenditure reduction highlights and types of reductions, plus a discussion of some of the impacts of those reductions. Finally, it includes a detailed listing and LFD analysis of the specific executive plan recommendations. This listing is intended as a working document for committees reviewing the executive budget plan.

SUMMARY EVALUATION OF REDUCTION PLAN

The executive spending reduction plan is summarized in Figure 6. The plan projects a fiscal 2003 ending general fund balance before reductions of a negative $22.0 million prior to special session action, and proposes $51.5 million in budget balancers, which are in addition to the $23.7 million in reductions ordered by the executive (including $0.7 million in voluntary reductions by the Legislative and Judicial Branches) in accordance with 17-7-140, MCA. These budget balancers would achieve a revised ending fund balance of $29.5 million, which is $2.3 million above the statutory target ending fund balance of $27.1 million.

Figure 6
Proposed Executive Reduction Plan
In Millions

	Executive 2003 Biennium	LFD 2003 Biennium	Difference 2003 Biennium
Projected Ending Fund Balance	**($21.954)**	**($34.562)**	**($12.608)**
Executive Propnsals to Reduce Deficit			
DOR Residual Equity Transfer - June	0.400	0.400	
Eliminate DOT Transfer - June	5.790	5.790	
Executive Proposal - August	45.260	45.260	
Potential Ending Fund Balance	**$29.496**	**$16.888**	**($12.608)**
Calculated Target Ending Fund Balance	27.162	27.176	0.014
Projected Budget Gap	**$2.334**	**($10.288)**	**($12.622)**

Column 2 of Figure 6 shows the LFD projected ending fund balance before reductions of a negative $34.6 million, and when the $51.5 million in executive budget balancers are applied to that projection, the result is an ending fund balance of $16.9 million, which is $10.3 million <u>short</u> of the statutory minimum ending fund balance of $27.1 million. The proposed reduction plan would not, therefore, achieve the statutory requirements of 17-7-140, MCA, using the LFD projections. The primary reasons for the difference, as shown in Figure 3 and discussed on Page 6, are the inclusion of higher estimates for expected supplemental appropriation for wildfire suppression costs in fiscal 2003 ($7.3 million) and Public Health and Human Services cost over-runs ($3.9 million) in the LFD projections.

The executive budget plan, when applying the executive's own revenue estimates and balance sheet assumptions, provides a viable framework for addressing the budget shortfall, and is based on reasonable estimates of the economy. LFD staff raise concerns and issues with specific budget balancers included in the proposal, but the majority of budget balancers are potentially viable options. However, the plan is

somewhat vulnerable in that it provides the minimum budget balancers necessary to get just above the minimum statutory required ending fund balance. It leaves no margin for further deterioration of a volatile economic picture, and leaves no provision for the highly probable costs of the fiscal 2003 wildfire season as well as other significant pressures for supplemental costs in human services. And if actual events result in a balance closer to the LFD projections, the vulnerability of the plan is clear. But the only significant difference from LFD projections is in projected supplementals, and the issue for the legislature is to determine if a larger ending fund balance reserve should be left in order to provide a safety net for these potential costs.

How effectively does the plan address Montana's underlying budget problem? The LFD staff has reported previously that the state faces not only a significant 2003 biennium shortfall, but that there is a longer-term structural imbalance between ongoing revenues and expenditures. Although the executive spending plan focused on addressing the current biennium budget shortfall, some of the reductions might provide a permanent reduction that will help address the out-year problem. While providing a partial solution to the longer term structural deficit, the executive approach was to concentrate on the immediate shortfall as required by statute, and defer permanent actions on long-term issues until a better assessment of the economic recovery can be determined and to allow for a less time-constrained venue for developing longer-term solutions. Development of long-term solutions to a structural imbalance in a short special session is difficult since long-term solutions generally require extensive analysis and are complex in nature. The structural imbalance in the general fund is discussed in more detail in the section "2005 Biennium Outlook", page 99.

GOVERNOR'S PROPOSED ADJUSTMENTS

The executive is proposing adjustments that would either reduce general fund expenditures or increase deposits into the general fund by $45.663 million[2].

Highlights of Executive Proposals

- Most proposals would have little to no immediate impact on state operations
- Proposals with impacts to agency operations total $10.1 million, or 22.1 percent of the total (including the Montana University System)
  - Personal services is the primary target, with reductions in the pay plan, a hiring freeze, and a two-day furlough
- Reduced payments and grants to local governments, individuals, or groups total $5.6 million, or 12.2 percent
- Reductions to schools total $10.1 million, or 22.1 percent of the total
- The proposals include over $23 million that would be of a strictly one-time nature such as use of fund balance
  - Some funding switches have no impact, while others could have a long-term impact on the source of the funds, including the highways state special revenue account, and environmental-based funds
- Selected reductions would be carried through the 2005 biennium, while others would apply only to fiscal 2003

Impacts of Executive Proposals

The adjustments can be put in a number of categories, as shown in the adjacent figure.

Executive Proposals by Impact
Fiscal 2003
(in Millions)

Impact Category	General Fund Adjustment	Percent of Total
Impact on Agency Operations	$10.088	22.1%
Reductions in Payments to Locals/Individuals/Groups	1.875	4.1%
Reduced Grants to Locals/Individuals/Groups	3.680	8.1%
Reduced Payments to Schools	10.102	22.1%
Proposals with Potential Long-Term Impact	14.194	31.1%
Other	5.724	12.5%
Total*	$45.663	

*Difference between this total and next figure is due to unexplained differences in coal tax and minor differences between the executive spreadsheet and written budget.

Impacts on Agency Operations

The primary impacts to agency operations are in personal services: a hiring freeze, a two-day furlough, and a reduction in the general fund portion of the fiscal 2003 pay plan. Higher education is reduced by about 3.5 percent. The reduction in personal services funding could have an impact on the timeliness, efficiency, and provision of state services. However, those impacts are difficult to gauge at this point.

[2] The actual reduction is $45.57 million. The difference between this figure and the figure on the balance sheet is due to an unexplained difference in coal tax and minor differences between the balance sheet and the Governor's written budget.

Reduction in Payments and Grants to Locals/Individuals/Groups

About 12.2 percent of the reductions would impact payments and grants by the state. Among the current recipients of these payments or grants are county governments, providers of chemical dependency programs, conservation districts, research facilities, and libraries. It should be noted many of the reductions are funds that have not been earmarked for a specific recipients, such as research and commercialization funds.

Reduced Payments for Schools

Schools would see a reduction in funding of $10.1 million, or 22.1 percent of the total. Among the reductions is elimination of the school flexibility account ($200,000 would be maintained for testing costs), diversion of two years of timber harvest proceeds designated for school technology, and a reduction in guaranteed tax base payments.

Potential Long-Term Impacts

In this category are certain actions that do not have an immediate impact on agency operations or the provision of service, but could reduce the level of activity for certain functions in future years. Among these reductions are diversions of fund balances in the highways special revenue account, accommodations funds, and the orphan share account; as well as diversion of revenue from certain environmental accounts, and parks and arts trusts. Therefore, while current service will not be impacted, the legislature should be aware that future activities could be impacted.

Appendix C has a detailed listing of each proposal by category.

How Permanent are the Proposed Adjustments?

As stated elsewhere in this report, Montana faces a significant structural imbalance. Indications are that long-term revenue growth prospects have diminished from the level experienced in prior years. Consequently, the legislature could be faced with the prospect of reducing budgets from the level that will be used to establish the 2005 biennium budget base (actual fiscal 2002 expenditures). In examining the proposed budget adjustments, LFD staff also examined the long-term viability of some of the cuts.

The legislature could continue many of the proposals offered by the Governor, while continuation of others would require an adjustment in priorities or expectations for service. Among the reductions that are clearly of a one-time nature are those shown in the adjacent figure.

One-Time Adjustment Proposed by the Executive
Fiscal 2003

Adjustment	Anticipated General Fund
Accommodations Tax* Fund Switch (1)	$1,915,000
Highways Special Revenue Fund Switch (2)	8,240,751
Hiring Freeze	1,400,000
Pay Plan 20 Percent Reduction (3)	4,222,937
ESA/Reed Act	4,000,000
RIT Excess	500,000
RIT Excess for Weeds	500,000
Orphan Share Balance	1,000,000
Timber for Technology	1,150,000
6 Mill Levy	209,915
Total	$23,138,603

(1) A portion could be continued, or the legislature could permanently change the allocation in statute

(2) Continuance at some level could be maintained. However, the legislature would need to change its expectation of construction activity

(3) Continuation would require continuance of higher vacancy savings or adjustment in statute/renegotiation of contracts

Other Impacts

State Employees

The adjustments proposed by the executive could have a significant cumulative impact on state employees, the operation of state government, and the provision of services. Among the requested adjustments are: 1) a reduction in funding for the fiscal 2003 pay plan that increases the vacancy savings rate of any agency funded in whole or in part with general fund; 2) a hiring freeze; and 3) a mandatory two-day furlough.

While no state employee layoffs are explicitly included, the cumulative impact of these proposals with the current vacancy savings requirement and other measures taken to maintain budget stability could result in employee layoffs in some agencies, or changes in other agency services if operating funds are transferred to cover personal services shortfalls.

Impacts by Agency

The following table shows the reductions, by agency. Please note that the reduction in general fund shown does not necessarily equate to a reduction in agency operations. For example, some of the reductions may be offset by increases in other funds. In addition to impacts of the current recommendations, the expenditure reductions ordered by the executive under the authority of 17-7-140, MCA are also shown for reference.

Impacts by Agency and Total General Fund Impacts

Sources Governor's Executive Budget, Special Session, Governor's Proposed HB 2; OBPP General Fund Impact Spreadsheet

Section/Agency	Proposed General Fund	Proposed Other Funds	Total Agency Impact	17-7-140 General Fund	17-7-140 Other Funds
Section A					
Legislative Branch	($118,621)	($8,294)	($126,915)		
Consumer Counsel		(2,616)	(2,616)		
Judiciary	82,280	(6,488)	75,792		
Mt Chiropractic					
Governor's Office	(58,120)	(1,291)	(59,411)	($491,329)	
Secretary of State		(10,218)	(10,218)		
COPP	(3,768)		(3,768)	(16,850)	
State Auditor		(20,214)	(20,214)	(11,792)	
Transportation		(689,715)	(689,715)	(5,715,814)	$5,715,814
Revenue (1)	(437,367)	(24,067)	(461,434)	(787,688)	90,000
Administration (2)	(63,777)	(307,155)	(370,932)	(429,664)	266,117
Appellate Defender	(2,764)		(2,764)		
Section B					
Public Health and Human Services	(4,135,634)	2,631,104	(1,504,530)	(9,601,759)	(23,216,867)
Section C					
Fish, Wildlife, Parks (3,4)	(257,707)	(91,064)	(348,771)	(24,304)	
Env Quality (5)	(47,878)	(412,177)	(460,055)	(252,691)	
Livestock	(9,189)	(36,453)	(45,642)	(39,180)	
DNRC (4)	(1,238,469)	133,424	(1,105,045)	(166,557)	
Agriculture (3,4)	(512,974)	(718,683)	(1,231,657)	(88,600)	25,000
Commerce (4)	(1,654,228)	(2,394,276)	(4,048,504)	(573,453)	(194,844)
Section D					
PSC		(11,754)	(11,754)		
Crime Control	(11,450)	(1,535)	(12,985)	(184,415)	
Justice	(8,447,801)	8,209,771	(238,030)	(845,239)	
Corrections	(714,158)	(15,547)	(729,705)	(2,297,533)	150,000
Labor/Industry	(911,540)	724,447	(187,093)	(140,193)	51,437
Military Affairs	(1,132,347)	1,095,800	(36,547)	(172,939)	
Section E					
OPI (6,7,8)	(3,463,537)	(6,107,094)	(9,570,631)	(978,430)	
Board of Public Ed	(2,254)	(547)	(2,801)	(17,774)	
MSDB	(64,377)		(64,377)	(295,638)	165,000
Montana University System	(5,465,118)	288,384	(5,176,734)	(5,152,142)	
Arts Council (4)	(287,109)	274,375	(12,734)	(54,793)	
Library Commission (4)	(22,076)	(131,105)	(153,181)	(97,715)	
Historical Society	(889,182)	722,349	(166,833)	(109,819)	
Statewide - HB 3 (LRBP) Reductions	(644,000)	-	-	-	-
Total	($30,513,165)	$3,089,361	($26,779,804)	($28,546,311)	($16,948,343)

General Fund Impacts Not Reflected in 'Proposed General Fund' Column	**Impact on General Fund**
1 - Elimination of increased liquor store commissions ($235,000 increase in general fund balance) is not reflected in totals	235,000
2 - Lottery fund balance transferred to general fund at fiscal year end. Part of 'other funds' reductions will increase the general fund balance	190,000
3 - Reduction in RIT ('other funds' - FWP - $150,000, Agric. - $500,000) will have positive effect on general fund balance	650,000
4 - Realloction of Coal Severance Tax revenues ('other funds' column) will have positive effect on general fund balance	1,678,796
5 - $1,000,000 transfer from Orphan Share program to general fund is not reflected in totals.	1,000,000
6 - Reduction in 'other funds' column is part of fund balance transfer ($4.6 million) to general fund.	4,616,000
7 - 'Other funds' column includes redirection of Timber Harvest for Tech revenues which will increase general fund balance.	1,200,000
8 - Additional increase to general fund balance from Timber Harvest for Tech. Revenues is not reflected in totals.	1,100,000
Total	$10,669,796
General Fund Impacts Not Reflected in LFD Spreadsheet Above	
Hiring Freeze of Non-Critical Positions	1,400,000
Personal Car Reimbursement Limit	400,000
Correct County Growth Percentages	430,000
Bozeman Accrual Issue	(220,000)
Metal Mines Tax / Oil and Gas Severance Taxes / US Mineral Royalties	2,167,000
Special Session Feed Bill	(400,000)
Total	$3,777,000
Other Impacts	
Corrections In OBPP Final Proposal	(49,000)
Unidentified Differences	352,039
Total General Fund Impacts:	$45,263,000
OBPP-Reported General Fund Impacts	$45,263,000

Introduction to Discussion of Executive Proposals

The following section is a discussion of each of the Governor's budget balancing proposals.

Content of the Report

Each proposal of the executive is presented in the following general format:

1) LFD staff briefly summarizes the proposal.
2) LFD issues and comments are presented where relevant throughout the discussion.
3) LFD staff indicates whether the proposal could be maintained over time, with or without further legislative action.
4) In many instances, the executive has requested language be added, stricken, or amended in HB 2. If so, it is recreated and noted for discussion and vote.

Structure of the Report

The report is designed to be a working document for legislative action. As such, it discusses each proposal, rather than each affected agency, in turn.

For example, the executive proposes to use accommodations tax fund balance to fund programs or functions in several agencies. Rather than discuss each agency in turn, the accommodations tax proposal is discussed all at once, allowing the legislature to make a decision on the use of the accommodations tax in one discussion.

Several of the proposals are contingent upon the passage of other bills. The structure of the report allows the legislature to discuss both the HB 2 and/or other legislation components of each proposal at the same time. Cross reference is made to each contingent bill so that, if necessary, the Appropriations and Senate Finance Committees can hold hearings on the relevant bills, either in the context of the requested changes in HB 2 or as necessary for independent bill action.

The following table shows each executive proposal, in the order in which it appears in the report. The table roughly follows the section order (General Government, Health and Human Services, etc.) used by the legislature in HB 2 action.

Summary Table for Executive Action

Proposal	General Fund Total Proposed Adjustment	Other Funds Total Proposed Adjustment	General Fund HB 2	General Fund Other	Other Bill No.	Page Number
Fund Transfers to the General Fund						
To Effect 17-7-140 Reductions						
Revenue - Residual Equity Transfer	($400,000)		($400,000)		Legal Issue	42
Transportation - Fund Balance Transfer	(5,715,814)				HB 5	43
Commerce - Research and Commercialization	(485,000)			(485,000)	HB 5	44
Fund Transfers to the General Fund - New						
Commerce - Research and Commercialization	(1,200,000)			(1,200,000)	HB 5	44
Orphan Share Account	(1,000,000)		(1,000,000)		HB 9	
Judiciary						
Additional Staff for New Judges	152,137		152,137			
Department of Administration						
Lottery Administrative Savings*	(190,000)		(190,000)	(190,000)		
Public Health and Human Services						
Alcohol Tax for Medicaid	(1,000,000)	1,000,000	(1,000,000)		SB 1	
Language to Allow Benefits Movement	-	-				
Economic Development						
Commerce - Certified Communities	(425,000)			(425,000)	HB 10	
Agriculture - Growth Through Agriculture	(500,000)			(500,000)	HB 10	
Research and Commercialization (see "Fund Transfers")					HB 5	
Coal Tax						
Coal Board	(435,000)		(435,000)		HB 10	
Conservation Districts	(330,000)		(330,000)		HB 10	
Growth Through Agriculture	(193,000)		(193,000)		HB 10	
State Library	(130,096)		(130,096)		HB 10	
Arts Council Grants		(6,000)			HB 10	
Unexplained Coal Tax	(54,000)					
Long Range Building	(644,000)			(644,000)	HB 10	
Parks and Arts Trust Funds						
Parks	(408,000)	(14,300)		(408,000)	HB 10	
Arts Council	(203,000)			(203,000)	HB 10	
RIT Related - Metal Mines, Oil and Gas, Excess Balance						
Excess Balance						
Weed Fund	(500,000)		(500,000)		HB 9	
HB 2 Funding Switch	(500,000)		(500,000)		HB 9	
Diversions to General Fund						
Metal Mines Tax	(411,000)			(411,000)	HB 10	
Oil and Gas Severance Tax	(1,516,000)			(1,516,000)	HB 10	

Summary Table for Executive Action

Proposal	General Fund Total Proposed Adjustment	Other Funds Total Proposed Adjustment	General Fund HB 2	General Fund Other	Other Bill No.	Page Number
Accommodations Tax Funding Replacement						70
Department of Fish, Wildlife, and Parks (Parks Division)	(257,707)	257,707	(257,707)			
Montana Arts Council						
Folklife Program	(56,800)	56,800	(56,800)			
Cultural and Aesthetics Grant Program*	(223,575)	223,575		223,575	HB 8	
Historical Society						
Museum Program	(289,390)	289,390	(289,390)			
Historical Sites	(59,829)	59,829	(59,829)			
Library Archives Program	(461,192)	461,192	(461,192)			
Publications	(51,506)	51,506	(51,506)			
MSU-Bozeman - Museum of the Rockies	(515,000)	515,000	(515,000)			
Department of Justice						73
Motor Vehicle Division	(8,240,751)	8,336,799	(8,240,751)			
Employment Security Account						76
PHHS - Disability Services/Voc Rehab Services	(1,965,199)	1,965,199				
DOLI - Job Services Division	(889,791)	911,561	(889,791)			
Department of Military Affairs - Challenge Program	(1,083,359)	1,123,240	(1,083,359)			
Education						78
K-12 Timber Harvest Technology Funds*	(2,300,000)			(2,300,000)	HB 4	
K-12 Flex Fund	(4,616,000)		(4,616,000)			
K-12 DSA to GTB 0.3 Percent Change	(1,151,000)		(1,151,000)		SB 3	
Higher Education	(3,190,000)		(3,190,000)			80
Statewide Reductions						
2 Day Furlough	(1,052,662)	(1,828,193)		(2,880,855)	LC 35	84
Hiring Freeze on Non-Critical Employees*	(1,400,000)				LC35	87
HB 13 pay Plan 20 Percent Fiscal 2003 Reduction	(4,222,937)	200,000		(4,153,900)	HB 3	89
Personal Car Reimbursement Limit*	(400,000)			(400,000)	HB 6	93
US Mineral Royalties**	(740,000)			(740,000)	HB 11	60
HB 124**						94
Correct County Growth Percentages	(430,000)			(430,000)	LC 24	
Technical Correction to District Block Grants	(1,775,768)			(1,775,768)	LC 24	
GTB Backfill of Block Grant	575,000			575,000	LC 24	
Technical Correction to County Block Grants	(1,330,809)			(1,330,809)	LC 24	
GTB Backfill of Block Grant	277,000			277,000	LC 24	
Eliminate Distributions on 6 Mill Levy	(209,912)			(209,912)	LC 24	
Bozeman Accrual	220,000			220,000	LC 24	
Liquor Store Incentive*	(235,000)			(235,000)	SB 2	97

*Increase in general fund balance.
**Bills heard in Taxation Committees
***Current LFD revenue estimates would reduce general fund by $383,310 for metal mines and $1,258,000 for oil and gas.
****Current LFD revenue estimates would reduce general fund by $632,000.

Department of Revenue - Residual Equity Transfer

The executive proposes a residual equity transfer of $400,000 to the general fund from the proprietary fund of the Customer Service Center in the Department of Revenue.

LFD COMMENT This proposal was originally a part of the executive 17-7-140, MCA, general fund expenditure reduction plan. However, the LFD raised a concern in its analysis regarding legality of this residual equity transfer because of the statutory requirement in 17-4-106, MCA. This law specifies that the balance remaining in the fund must be carried forward for use in reducing future fees. The current proposal contained in HB 2 would include language in the general appropriations act that directs this residual equity transfer.

Ongoing? No. The fund balance would not be adequate to support subsequent transfers.

HB2 Language Requested

"It is the intent of the legislature that the department transfer $400,000 of fund balance from the customer service center internal service proprietary account to the general fund. The department received a supplemental appropriation in the 2001 legislative session for costs associated with the customer service center, and beginning in fiscal year 2002, the majority of the center was moved into House Bill No. 2 and is no longer in an internal service fund. Only collection services remain in the internal service fund. At the end of fiscal year 2001, there was $400,000 remaining from the supplemental appropriation in the internal service fund. Although 17-4-106(2) requires collections deposited in excess of the amount appropriated for operations to be carried forward into the next fiscal year for operations of the debt collection program, the supplemental appropriation was not a collection amount and more properly belongs in the general fund."

LFD ISSUE Implementing the proposal in HB2 would be an attempt to amend substantive law through the general appropriations act and would not be legal. A better way to affect this transfer would be to amend the section of law that directs how the excess funds must be treated. A bill could be introduced to allow this transfer without requiring the proposed HB2 language.

Department of Transportation State Special Revenue Nonrestricted Account

The executive proposes revising the general fund transfers to the Department of Transportation state special revenue non-restricted account for the 2003 biennium provided for in 15-1-122, MCA. This proposal would eliminate the fiscal 2002 transfer of $2,873,853 and reduce the fiscal 2003 transfer by $2,841,961 to $75,000.

LFD COMMENT This proposal was originally a part of the executive 17-7-140, MCA, general fund expenditure reduction plan. However, the LFD raised a concern in its analysis regarding executive authority to amend substantive law. The current proposal contained in Section 1 of HB 5 would implement this proposal by amending the transfer amounts specified in 15-1-122, MCA, for the 2003 biennium.

Ongoing? Yes. However the general fund transfer was established to offset revenues lost to the highways state special revenue account when the 2001 legislature passed HB 124. Sustained loss of this transfer would degrade the stability of the account and would begin to impact highway construction and maintenance activities and may lead to an inability to match federal funding. Additionally, the sustained loss could jeopardize Montana's maintenance of effort on federal-aid highways, which could lead to a higher state match percentage to receive federal highway funds.

Research and Commercialization Transfer Reduction

This proposal would revise 15-35-108 MCA to reduce the transfer from the general fund into the Research and Commercialization Special Revenue Account (Expendable Trust) from $4.85 million each year to $3.165 million in fiscal 2003, and $3.65 million in fiscal years 2004 and 2005. This equates to a $1.2 million reduction each year, in addition to the Governor-ordered reduction of $485,000 in fiscal 2003.

LFD COMMENT Per the Department of Commerce, the reduced transfer in fiscal 2003 would still enable the Board of Research and Commercialization to meet all commitments. However, assuming satisfactory progress of previously awarded projects expecting continued funding, this reduction would not allow the Board to support projects not previously awarded. A similar situation would occur in fiscal 2004 and 2005, although the impacts relative to fiscal 2003 are expected to be diminished as funding for previously-awarded programs decreases or terminates.

Ongoing? Yes. Proposed legislation carries the reduction through fiscal 2005, when the original provision for the transfer terminates.

Judiciary Increase for Ravalli and Cascade Judgeships

This proposal adds $152,137 general funds to the Judiciary's District Court Operations program for staffing costs related to two new district court judges added by the 57th Legislature. Of the total amount, $7,898 is proposed as a one-time-only appropriation to fund the startup costs for the new judgeships.

> **LFD COMMENT** HB 214 provided for an additional district court judge in Ravalli and Cascade counties. The new judges will take office in January 2003 following the November 2002 general election. The legislature approved $129,000 general fund in fiscal 2003 for salary and benefits, training, travel expenses, and computer hardware and software for each judge. Costs associated with additional support staff for each new judge was not considered. This proposal would fund the salaries of a court reporter and law clerk in each county along with administrative costs associated with each new judgeship.

Ongoing? Yes. However this proposal only reflects the personal services and administrative costs for 6 months in fiscal year 2003 since the judges will not take office until January 2003 following the November 2002 general election. Therefore, future biennium costs would be approximately double the requested amount.

Lottery Administrative Savings

The executive proposes reducing State Lottery administrative costs by $190,000 in fiscal 2003.

LFD COMMENT Section 6 of HB2 would implement this proposal by reducing the fiscal 2003 appropriation of proprietary funds. Funding for the operations of the State Lottery are appropriated by the legislature because net lottery revenues, after prizes, sales commissions, and operating expenses are deducted from sales revenue and interest earnings, are transferred to the general fund. This proposal would reduce operating expenses for marketing research, point of sale advertising, and promotions done through special events.

Ongoing? Yes. But could potentially impact marketing effectiveness and ultimately maximization of revenues and therefore revenues available to the general fund.

Alcohol Tax for Medicaid

The executive proposes to amend section 53-24-108, MCA to discontinue distribution of $1 million in alcohol tax proceeds to state approved, county non-profit alcohol prevention, treatment, and rehabilitation programs and use the $1 million to offset general fund match for Medicaid benefits. The executive points out that increases in two other funding sources over the past several years should offset this reduction. The federal Substance Abuse Block Grant (SAPT) has increased $2.7 million and Medicaid payments to programs are expected to increase from $0.8 in fiscal 2002 to $1.8 million in fiscal 2003.[3]

LFD ISSUE

Important points related to the executive proposal that the legislature may wish to consider are:

- block grant and Medicaid funding are not distributed among programs in the same proportion as alcohol tax proceeds
- alcohol tax proceeds are a much more flexible funding source than block grant and Medicaid funding
- alcohol tax is used as a match for other grants, which may be reduced or eliminated without necessary matching funds
- a Medicaid intergovernmental transfer (IGT) program partially offsets the need for the $1 million alcohol tax diversion

The Department of Public Health and Human Services (DPHHS) contracts with 27 approved chemical dependency programs that provide services in all 56 counties. DPHHS cannot provide an estimate of the number of persons who receive services supported by alcohol tax.

State approved programs are supported by alcohol tax funds, the federal SAPT block grant and private payments. Some of the larger state approved programs are also Medicaid providers and receive Medicaid funding. Some programs receive other federal grants and in some cases, the alcohol tax funds provide the non-federal match required for those federal grants. Therefore, a reduction in the alcohol tax may reduce or eliminate receipt of other federal grants.

Alcohol tax is the most flexible funding source that supports state approved county programs. Other funding sources stipulate criteria governing how funds must be spent. Reducing alcohol tax funds for state approved programs will limit administrative flexibility to design and deliver services deemed appropriate by the program. Additionally, programs may not have as much funding to deliver services to low-income persons with incomes or resources above Medicaid eligibility levels if alcohol tax funds are reduced. In some smaller programs, alcohol tax may support up to 50 percent of the treatment budget.

About 20 of the 27 state approved programs have limited staff resources, sometimes with as few as 1 or 2 staff members. Staff for smaller programs act as both administrative and treatment staff. The 2001 Public Health and Human Services Joint Appropriation Subcommittee heard testimony from staff of

[3] The Department of Public Health and Human Services receives the following portions of liquor license, wine and beer taxes: 65.5 percent of the 10 percent liquor license tax on the retail price of liquor sold and delivered in the state by a company that manufactured, distilled, rectified, bottled, or processed and that sold more than 200,000 proof gallons of liquor nationwide in the preceding calendar year or 8.6 percent if less than 200,000 proof gallons in the preceding calendar year; $1 of $4.30 tax per barrel of beer; 31 percent of the 27 cents per liter tax imposed on table wine; and 31 percent of the of 3.7 cents per liter tax imposed on hard cider.

LFD ISSUE (Cont.) smaller programs indicating they would not become Medicaid providers because of the complexity of administering Medicaid and limited staff resources. So, increases in Medicaid funding would not benefit programs unless the program participated in Medicaid. For instance, based on its estimated billing one of the larger programs accounted for 18 percent of the total statewide estimated chemical dependency Medicaid payments in fiscal 2002.

Increases in the SAPT block grant were fully allocated in fiscal 2002. Therefore, reductions in alcohol tax distribution will reduce fiscal 2003 budgets for state approved programs without increases from other funding sources. As noted earlier not all programs anticipate becoming Medicaid providers and alcohol tax reductions may result in reductions in other funding sources if alcohol tax provides the match.

<u>Other Options</u>

To partially offset the alcohol tax transfer, DPHHS could consider implementing an Inter Governmental Transfer (IGT) as allowed by federal regulations and as directed by the 2001 legislature.[4] Under an IGT program, counties transfer funds to DPHHS to be used as Medicaid matching funds to pull down additional federal funds for Medicaid eligible services administered and funded by counties. The 2003 biennium Medicaid services match rate is about 28 percent state and 72 percent federal. So for every $1 in additional county funds forwarded to DPHHS, it can draw down about $2.50 in new federal funds. DPHHS can draw down additional federal funds up to the upper payment limit, which is the Medicare rate or a rate that would be paid using a Medicare reimbursement methodology. The legislature approved an IGT program for nursing homes and hospitals and directed DPHHS to undertake IGT programs for mental health and chemical dependency services.

The state returns the funds forwarded from each county back to the respective county and has several options in allocating the new federal matching funds. The state can return all of the additional funds to counties or it can return a certain percentage to counties and retain the balance not returned to counties. Under the nursing home IGT, counties received payment at double their initial contribution and the state retained the balance to use as Medicaid match in the mental health program.

The amount of funds that could be generated from a chemical dependency IGT would be small initially because the total amount of Medicaid services is projected to be only $1.8 million in fiscal 2003. Between $250,000 and $650,000 could be generated if the plan could be implemented by January 1, 2003, and depending on the upper payment limit and total Medicaid payments to state approved programs between January and June 30, 2003.

DPHHS would need to take the following steps in order to implement an IGT for chemical dependency programs:

- determine the upper payment limit for each major chemical dependency service
- determine the difference between the upper payment limit and current chemical dependency rates
- calculate the maximum additional federal revenue that can be drawn down
- determine how much of the additional revenue would be returned to counties that participated and how much would be retained by the state
- submit the IGT plan to the federal Department of Health and Human Services for approval

[4] This idea is also briefly discussed in "Refinancing General Fund Expenditures with Federal Funds". It is likely that DPHHS will need additional staff that would need to be exempt from the hiring freeze, in order to implement this idea.

LFD ISSUE (Cont.)

- o amend the state Medicaid plan
- o provide education to counties about the concept
- o implement contracts with counties that wished to participate

There are consultants that specialize in determining upper payment limits, probably the most critical element of a chemical dependency IGT plan. So DPHHS could purchase the expertise it needs to undertake this plan. Using consultants should also speed up the process so that the IGT could be implemented in fiscal 2003.

LFD ISSUE The legislature may wish to consider requiring DPHHS to implement a chemical dependency IGT plan as either a condition of an appropriation in HB 2 or by amending statute. The legislature could specify what percentage of IGT funds should be returned to participating counties and what amount should be retained by the state and how it should be used. The legislature may also wish to appropriate funds for DPHHS to purchase the services necessary to implement an IGT. DPHHS has undergone continuing spending reductions since November 2001 and does not have additional staff or financial resources to quickly implement an IGT.

Ongoing? Yes. This proposal would be ongoing and would eliminate distribution of alcohol tax proceeds from the DPHHS account to counties.

<u>HB2 Language Requested</u>

The proposal to use alcohol tax proceeds in place of general fund Medicaid match requires an amendment to section 53-24-108, MCA, which is included in SB 1. The executive proposes to effect the funding shift in HB 2 and has proposed that the legislature adopt this language:

> *"Item 10 includes a $1,000,000 reduction in general fund money in fiscal year 2003 for medicaid services to be replaced by the redistribution of state special revenue funds currently generated by taxation on alcoholic beverages and distributed to counties."*

This language would require a $1 million reduction in general fund in the Addictive and Mental Disorders Division even if SB 1 did not pass. The proposed language is an implied amendment to statute, which would be illegal if SB 1 did not pass. The legislature may wish to make the general fund reduction contingent on passage and approval of SB 1.

LFD ISSUE The legislature may wish to consider the following language if it chooses to accept the executive proposal to implement the $1 million alcohol tax funding shift: "Contingent on passage and approval of senate bill no. 1, fiscal 2003 general fund money in item 10 is decreased by $1,000,000 and fiscal 2003 state special revenue funds are increased by a like amount."

Request Change in Benefits & Claims Language

The executive has requested that the following language be deleted from HB 2:

> "Funds appropriated for grants or benefits and claims or indicated in legislative intent as having been appropriated for grants or benefits and claims may be expended only as grants or benefits and claims. The office of budget and program planning may authorize a transfer of appropriation authority from grants or benefits and claims to another category of expenditure under one of the following conditions:
>
> *(1) the department certifies to the office of budget and program planning that federal law or regulations require that funds appropriated in grants or benefits and claims must be expended in a different category of expenditure; or*
>
> *(2) the department certifies to the office of budget and program planning that there will be savings if funds appropriated in grants or benefits and claims are transferred and expended in another category of expenditure.*
>
> The office of budget and program planning shall report to the legislative finance committee on transfers approved subject to these two conditions."

LFD ISSUE

The legislature could consider making the amendment effective for fiscal 2002 only by inserting the words "In fiscal year 2002," prior to the beginning of the language. This amendment would retain the restriction in fiscal 2002 and allow the executive amendment to be effective in fiscal 2003. Since agencies can make adjustments to prior year expenditures, unexpended grant and benefit appropriations that were reverted due to compliance with this language could be used for other purposes if the language is stricken.

Elimination of Certified Communities Program Funding

This proposal eliminates the $425,000 statutory appropriation provided in 15-35-108 MCA for the Certified Communities Program in the Business Resources Division within the Department of Commerce. The elimination is for fiscal 2003 only.

LFD COMMENT 90-1-116 MCA provides the mechanism for the state to provide economic development grants to communities. The purpose of the Certified Communities program as defined by the department is "to establish and maintain an active network of trained communities that are prepared to respond quickly and efficiently to economic development opportunities." The statutory $425,000 is the sole source of funding for the program, with approximately $34,000 being spent on administration, and the rest of the funding being used to provide grants on a matching $1 per $1 basis to communities who have achieved "certified" status through the program's review and certification process.

No grants have been awarded for fiscal 2003, although some administration costs may have already been incurred. The next round of grants is to be awarded in March of 2003.

Ongoing? No. Statute would have to be changed to carry the elimination through fiscal 2005, when the original provision for the statutory appropriation terminates.

Growth Through Agriculture Reduction

This proposal revises 15-35-108 MCA to reduce the $1.25 million statutory appropriation provided for the Growth Through Agriculture program within the Department of Agriculture to $750,000 in fiscal years 2003 through 2005, after which the appropriation sunsets.

LFD COMMENT Per the Department of Agriculture, and contingent upon discussions with the Agricultural Development Council, reductions to the Growth Through Agriculture program will most likely reduce the number of grants awarded by the Agricultural Development Council, but will not affect program staff or infrastructure.

LFD COMMENT Although unrelated to this proposal, the Growth Through Agriculture program is also proposed to be reduced by revising 15-35-108 MCA to reduce revenues into the Coal Several Tax Shared State Special Revenue Account. The effect of this proposal for fiscal 2003 would be a general fund reduction of $193,000 upon passage and approval of House Bill 10.

Ongoing? Yes. The proposal as drafted carries the reduction through fiscal 2005, after which the appropriation sunsets.

Coal Severance Tax Distribution

The executive proposal temporarily changes the distribution of the coal severance tax through fiscal 2005. The proposal eliminates the coal severance distributions earmarked for park acquisitions and maintenance and the arts trust funds. Additionally, the proposal reduces the proportion of severance tax distributed to the long-range building program by 2 percent and the Shared Special Revenue account by 50 percent. The table below shows the current law distribution of the coal severance tax, the executive's proposed temporary changes through fiscal 2005, and the distribution in the final version of 15-35-108 MCA in percent terms. The remaining revenues would flow into the general fund. These actions will increase the distribution to the general fund by 8.1 percent. The executive estimates that the change will be $2.4 million.

Proposed Changes in Coal Severance Tax Distributions

Program	Current Law	Executive Proposal	Executive Proposal from 7/1/2005	Executive Proposal Savings
Coal Trust	50.00%	50.00%	50.00%	$0
LRBP	12.00%	10.00%	12.00%	644,000
Deposit to Shared Special Revenue Account	8.36%	4.18%	8.36%	1,098,000
Parks, Aquision and Maintence	1.27%	0.00%	1.27%	408,000
Renew. Resource Loan Debt Service	0.95%	0.95%	0.95%	0
Works of Art for Capital and C&A	0.63%	0.00%	0.63%	203,000
Sub-total	73.21%	65.13%	73.21%	$2,353,000
General Fund	26.79%	34.87%	26.79%	

Each of these proposed reductions is discussed in further detail below.

<u>Coal Severance Tax Shared State Special Revenue Account – Change to 4.18 Percent of Overall Collections</u>

This proposal would revise 15-35-108 MCA, to decrease the statutory allocation of Coal Severance Tax revenues into a state special revenue account shared by the Departments of Agriculture, Commerce, and Natural Resources and Conservation; and the State Library Commission. This allocation would be a 50 percent reduction, from 8.36 to 4.18 percent of the overall collections. This statutory change would reduce the allocations for fiscal years 2003 through 2005. Net result upon most affected agencies is a 50 percent reduction to the fiscal 2003 appropriations provided during the 2001 regular session. The following chart shows the revenues and appropriations as approved during the 2001 session, current revenue projections, and projected expenditures based on the Governor-ordered reductions and the reductions proposed for the special session:

Combined Coal Tax Account
8.36% of Coal Severance Taxes
2003 Biennium

		Fiscal 2001	Fiscal 2002	Final 2001 Reg. Session Fiscal 2003	Gov. Reduct./ Spec. Session Fiscal 2003
8.36% Actuals/Estimates		**$2,783,000**	**$2,831,000**	**$2,827,000**	**$2,640,000**
4.18% Estimate					**$1,320,000**

Uses	Fiscal 2000 Actuals	Fiscal 2001 Appropriated	Fiscal 2002 Requested	Fiscal 2003 Requested	Fiscal 2003 Requested
Growth Through Agriculture (Agriculture)	$384,601	$411,382	$386,476	$386,473	$193,473
Local Impacts - Coal Brd (Commerce) (1)	1,186,271	889,885	1,201,084	1,262,978	633,136
County Land Planning (Commerce) (2)	198,693	198,693	198,693	198,693	198,693
Conservation Districts (DNRC)	651,194	656,484	657,435	657,435	327,435
Conservation Districts (biennial)			100,000	0	0
Library Services (State Library Commission) (3)	279,563	266,302	284,227	284,227	134,323
Total Appropriated/Requested	**$2,700,322**	**$2,422,746**	**$2,827,915**	**$2,789,806**	**$1,487,060**
Difference (Based on 8.36%)			$3,085	$37,194	$1,152,940

(1) Coal Board reduction of 50% includes HB 2 reduction ($435,000) and previous Gov-ordered reductions ($194,842)
(2) Appropriation for County Land Planning is not proposed to be reduced in HB2
(3) State Lib. Commission Reduction of 53% includes HB 2 reduction ($140,000) and previous Gov-ordered reductions ($9,904)

Overall net effect of 2003 reductions on GF:	$1,115,746
Previous Governor - ordered Reductions:	($204,746)
Net positive effect of Special Session proposals on GF:	$911,000

LFD COMMENT It should be noted that while Coal Board appropriations would only be decreased by 34 percent in HB2, the overall reduction to the Coal Board is 50 percent when added to the expenditure reductions previously ordered by Governor Martz. Reductions to the Coal Board program would affect the number of grants awarded by the Coal Board to impacted communities.

LFD COMMENT Per the Department of Agriculture, and contingent upon discussions with the Agricultural Development Council, reductions to the Growth Through Agriculture program will most likely reduce the number of grants awarded by the Agricultural Development Council, but will not affect program staff or infrastructure.

LFD COMMENT Although unrelated to this proposal, the Growth Through Agriculture program is also proposed to be reduced by $500,000 by reducing the statutory appropriation provided in 15-35-108. This proposal is also contained in House Bill 10.

LFD COMMENT The $140,000 reduction to the Library Commission will impact state special revenue funding for federation grants and the materials and online book budget.

MCA Title 22, Chapter 1, Part 4 allows state funds to be appropriated to the Library Commission to provide the benefits of quality public library service to all residents of Montana through library

LFD COMMENT (Cont.)

federations. Five library federations exist throughout the state serving public libraries and public school libraries in their region. Federations use state funds for training, grants, and materials in their regions. State funding for fiscal year 2003 is $97,217, which would be eliminated under this proposal through fiscal year 2005.

This proposal, combined with the $9,904 spending reduction previously ordered by Governor Martz, will also deplete state special revenue funding for the materials and online book budget impacting library resources available to constituents. The Governor's Office is recommending that the HB 2 reduction be amended to $130,096 in the House Appropriations Committee to recognize the earlier reduction.

LFD COMMENT

The appropriated amount for the Conservation Districts will be reduced by $330,000 upon passage and approval of the bill with the primary impact being on conservation districts. Conservation districts throughout Montana use coal tax funds for basic operations and in programs administered at the local level. The following are among the potential impacts of funding reductions:

- Districts may reduce the hours of support staff.
- Funds are used to administer 310 permitting law as directed by state law (Natural Streambed and Land Preservation Act of 1975); for legal and engineering support; and for support of watershed projects at the local level. Districts process approximately 2,000 permit requests per year. Because permitting decisions have become increasingly sophisticated, cuts in coal severance tax allocations will likely slow permit processing, which may result in more contested permit decisions and an increase in arbitration proceedings.
- Conservation districts use the funds at the local level to match federal funds available from the US Department of Agriculture, EPA, and other federal agencies. The department estimates that over $5 million per year in federal funds is received by districts all over the state. If the funds are reduced, the local conservation districts would be limited in their ability to secure federal match dollars.

LFD ISSUE

The far-right column of the chart (page 54) shows projected revenues into the account for both the current 8.36 percent allocation ($2.64 million) and the proposed 4.18 percent allocation ($1.32 million). These figures are based on the most current projections for Coal Severance Tax revenues. The far-right column also shows projected expenditures from the account based on the Governor-ordered expenditure reductions in addition to proposed appropriation reductions in House Bill 2. These projected expenditures equal approximately $1.49 million, which is significantly higher than projected revenues into the account if the allocation is reduced to 4.18 percent. This is mainly due to two reasons: 1) The original appropriations were based on previous revenue projections; and 2) The appropriation for County Land Planning in the Department of Commerce is not proposed for reduction.

Therefore, if the statutory allocation is reduced to 4.18 percent and revenue estimates hold true, some or all of the programs using this funding will not be allowed to expend their entire fiscal 2003 funding authority, even with the current and proposed expenditure and appropriation reductions.

LFD ISSUE

Although appropriation reductions in House Bill 2 equal $1,098,000 under this proposal, the net positive effect of this proposal on the general fund will be only $911,000, due to fiscal 2003 estimates being reduced by approximately $187,000 from those adopted by the 2001 legislature.

Ongoing? Yes. The proposal would modify statute through the end of fiscal year 2005.

Language Requested

Department of Natural Resources and Conservation – "Item 3 will be reduced by $330,000 in state special revenue if HB 10, August 2002 Special Session, is passed and approved."

Department of Agriculture – "Item 3 includes a reduction of $193,000 in state special revenue, which is contingent on passage and approval of HB 10, August 2002 Special Session."

Department of Commerce – "Item 7 includes a reduction of $435,000 in state special revenue, which is contingent on passage and approval of HB 10, August 2002 Special Session."

State Library Commission – "Item 1 includes a reduction of $140,000 in state special revenue, which is contingent on passage and approval of HB 10, August 2002 Special Session."

Cultural Trust Fund – Re-allocation of Revenue to General Fund

This proposal would revise 15-35-108 MCA, to remove the 0.63 percent statutory allocation of coal severance tax revenues into the cultural trust fund for fiscal years 2003 through 2005. Revenue flowing into the trust fund of approximately $199,000 annually would be diverted to the general fund.

LFD COMMENT Interest earnings from the trust fund are appropriated to the Arts Council for cultural and aesthetic projects. Anticipated earnings will be less due to the proposed funding shift. Net result upon the Art Council is an estimated $14,500[5] reduction in cultural and aesthetic grant funding for fiscal year 2003 and continuing through fiscal year 2005.

Interest income in fiscal 2002 was approximately $12,000 less than projected and is expected to continue at the lower level in fiscal 2003. This further reduces biennium funding for cultural and aesthetic grants by $24,000. Also, $25,000 was included in the expenditure reductions previously ordered by Governor Martz. These reductions can be mitigated by an approximate $59,000 cash returned to the cultural and aesthetic account by the Department of Administration (D of A) due to an audit finding. Therefore, the only anticipated impact to grant recipients would be a result of this new proposal and could be partially mitigated by the remaining cash from the D of A.

HB 9 appropriated $926,130 over the biennium for C & A Grants of which $402,555 is from the cultural and aesthetic project account and $523,575 is from the general fund.

LFD ISSUE The fiscal year 2003 estimated impact to the agency of $14,500 differs from the estimated impact identified in the Governor's proposal of $6,000. There is also a difference of approximately $4,000 in the net positive effect on the general fund as the LFD estimates

[5] The estimated $14,000 impact is based on the most recent LFD revenue estimates and information from the Board of Investments on interest rates.

LFD ISSUE (Cont.)

$199,000 and the Governor's proposal specifies $203,000. These differences are due to the revenue estimates and interest rate used by each office as illustrated in the following table:

Cultural Trust Fund	LFD Analysis	Governor's Proposal	Difference
Fiscal Year 2003 Coal Tax Collections (1)	$31,579,000	$32,222,000	-$643,000
Percent to the Cultural Trust	0.63%	0.63%	
Total to the Cultural Trust	$198,948	$202,999	-$4,051
Interest Rate (2)	7.30%	6.00%	1.30%
Annual Interest Income	$14,523	$12,180	$2,343
Earnings for Half a Year		$6,090	

(1) LFD Analysis based on most recent LFD revenue projections

(2) LFD Analysis based on 3/23/02 interest rate information from Board of Investments

18-Jul-02

An additional difference in the agency impact is due to the Governor's Office identifying the impact for half the year. However, as written, HB 10 contains an immediate effective date and retroactive applicability to July 1, 2002. Therefore, the impact would apply to the entire year.

LFD COMMENT

The Long Range Planning Cultural and Aesthetic grant program will experience reduced grant capabilities in the next biennium. The interest earned from the Cultural and Aesthetic Trust is used to fund the grant program. HB 10 would stop the flow of revenues from the coal severance tax for a three-year period. As a result, the grant program will necessarily be reduced. The interest earnings will be held at the 2002 level. The loss of earnings for the 2005 biennium will amount to $72,616, using the estimated 2003 revenue loss and the interest rate provided by the Board of Investments see (1) and (2) shown above.

Ongoing? Yes. The proposal would modify statute through the end of fiscal year 2005.

<u>Reduction of Coal Severance Tax allocation for the Long Range Building Program</u>

The executive proposes to reduce the statutory allocation of the coal severance tax in 15-35-108 MCA from 12 percent to 10 percent for the Long Range Building Program (LRBP). Reductions will be felt in the LRBP "cash program," and affect fiscal 2003, 2004, and 2005. The LFD estimates the 2 percent reduction to the LRBP allocation will amount to an additional $632,000 flowing to the general fund. The executive estimates the change to be $644,000 and has suggested reductions based on that figure. The proposed executive reductions are seen in the table titled Reductions to LRBP "Cash Program."

Reductions to LRBP "Cash Program"		
Project	Original Appropriation	Reduction
University System Master Plan	$100,000.00	$84,000.00
UM-COT, Helena, Design Development	365,000	200,000
Hazardous Material Mitigation Fund	440,000	100,000
Statewide Roof Replacements/Repairs	649,000	100,000
UM-Missoula Library Sprinkler System	657,000	55,000
Lewistown MMHNCC Sprinkler System	300,000	105,000
Total	$2,511,000	$644,000

LFD COMMENT The University system master plan will be discontinued as a result of the reduction. Additionally, the design construction documents for the Helena College of Technology will not be finished. This action is justified by the uncertainty of bonding for the project. If the projects are bonded in an upcoming session, the remaining design costs will be included in the bond issue. The hazardous material mitigation fund has not been used in fiscal 2002, and there are no projects requiring the funds at this time. The fund retains $350,000 to respond to any asbestos and other hazardous materials problems that might arise. Some roof projects will be postponed as a result of the reduced funding. However, no structural damage will occur to buildings because of the postponements. There is ample money available for emergency situations that might arise. The UM library sprinkler system project is completed, and the $55,000 reduction is the estimated savings on the project. The MMHNCC sprinkler system project has been estimated at $180,000. The reduction of $105,000 provides funding for the estimate plus $15,000 for contingencies.

LFD COMMENT The executive proposal for reductions in the LRBP provides specific reductions for fiscal 2003. During the 2005 biennium the reductions to the cash program will have a negative effect on the deferred maintenance program; there will be less money for the maintenance and repairs of existing state structures.

Ongoing? Yes. But the need for maintenance and repair funds grow with each year and with each new building project approved by the LRBP.

<u>Eliminate Deposits to Parks Trust</u>

If HB10 is passed and approved, 1.27 percent of the coal severance taxes currently allocated to the parks coal tax trust account will be redirected to the general fund until the end of the fiscal 2005 biennium. The Parks Division spends the interest earnings from this trust account to operate and maintain the state park system.

According to the executive, in fiscal 2001 approximately $400,000 was deposited in the trust account. Calculations conducted by the Board of Investments determined that with 7 percent interest earnings, this proposal will result in a loss of $14,300 the first year, $42,800 the second year, and $71,400 the third year for a total three-year loss of interest earnings of $128,500. The proposal redirects approximately $1.2 million over the three-year period away from the parks trust resulting in a long-term perpetual loss of interest earnings from the parks coal trust account of approximately $71,400 annually. According to the executive, reductions will be made in park maintenance for items such as weed control, road grading and repairs, toilet cleaning, lawn mowing and general site upkeep; and interpretation such as school group tours, educational materials, classroom programs, and brochures.

LFD COMMENT According to the executive, this funding is primarily used for on-going maintenance efforts in the state park system. Since maintenance of state parks is a legal priority for the department, the department must keep up on these activities. An alternative to utilizing coal severance taxes for these purposes would be to raise fees in several of the more popular state parks. According to FWP, eliminating senior discounts; increases in Smith River, camping, Lewis and Clark Caverns, and parks passports fees; and begin charging fees in primitive parks were among the increases that would have potential to offset the loss of parks maintenance dollars. The increased revenue generated from these fee increases could be used to replace coal severance taxes on a dollar for dollar basis.

Ongoing? Yes. The proposal would modify statute through the end of fiscal year 2005.

Resource Indemnity Trust (RIT)

The executive is proposing to change the way the Resource Indemnity Trust (RIT) related accounts are funded. Further, the executive is proposing to utilize money in the RIT above the $100 million threshold. Although it appears the proposed transfer and ultimate use of the excess money will be used for projects that are intended by the constitution, the legislature may wish to utilize this excess balance in other ways.

The Montana Constitution (Article IX, Section 2) requires the existence of the RIT and states, "The principal of the resource indemnity trust shall forever remain inviolate in an amount of one hundred million dollars ($100,000,000) guaranteed by the state against loss or diversion."

On February 27, 2002, the Governor certified that the trust exceeded the $100 million threshold. Thus, the RIT no longer receives any revenue. Instead, the Resource Indemnity and Ground Water Assessment Tax (RIGWA) and the applicable portion of oil and gas tax collections were to be allocated to the groundwater assessment, reclamation and development, coal bed methane protection, natural resource worker scholarship fund, and orphan share accounts.

These changes became effective immediately following the executive order certifying that the RIT trust balance reached $100 million. Table 1 shows the details of RIT proceeds, interest earnings, and related expenditure accounts for the 2003 biennium. In addition, bolded items illustrate changes proposed by the executive. These proposed changes and the potential impacts to the main RIT funds are discussed later in the report.

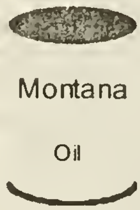
Table 1
Resource Indemnity Trust (RIT): Proceeds, Interest Earnings, and Related Expenditure Accounts
2003 Biennium Projections (Including Executive Special Sesssion Proposals After Trust Reaches $100 Million)

1

RIT Revenues (RATC estimates)	Fiscal 1997	Fiscal 1998	Fiscal 1999	Fiscal 2000	Fiscal 2001	Fiscal 2002	Fiscal 2003
Projected Beginning Balance FY 2003							$101,056,874
Adjust Fund balance to Reflect Actual on July 17, 2002							$500,750
RIT Trust Balance							**$101,557,624**
RIGWAT Coal, Oil, Natural Gas Proceeds	$1,431,779	$997,607	$900,648	$3,396,285	$1,570,000	$1,452,000	$0
RIGWAT Error Adjustments	0	0	0	0	(1,841,653)		
RIT Excess -- DNRC Funding Switch with General Fund							(1,000,000)
Legislative Changes -- **Weeds ($500K)**, Water Treatment ($540K)						0	(540,000)
Legislative Changes -- Clark Fork River Study							(120,000)
Legislative Changes -- Subdivisions, Cons. Dist., Irrigation grants						0	0
Total Deposits/Legislative Changes	$1,431,779	$997,607	$900,648	$3,396,285	($271,653)	$1,452,000	($1,660,000)
Trust Balance ($100 million floor)*	$94,581,987	$95,579,594	$96,480,242	$99,876,527	$99,604,874	$101,056,874	$99,897,624

2

	Fiscal 2001	Fiscal 2002	Fiscal 2003	Biennium Total
RIGWA and Oil and Gas Tax (RATC estimates)	$3,140,000	$2,904,000	$2,809,000	$5,713,000
RIGWA Tax		$1,140,000	$1,151,000	$2,291,000
Statutory Allocations -- RIGWA				
Groundwater Assessment Account-direct (02289)	300,000	300,000	366,000	666,000
Reclamation & Development-50% of Remainder (02458)	635,000	135,000	392,500	527,500
Natural Resource Worker Scholarship			150,000	150,000
Orphan Share Account- Remainder of RIGWA (02472)	635,000	135,000	242,500	377,500
TOTAL RIGWA STATUTORY ALLOCATIONS	1,570,000	570,000	1,151,000	1,721,000
Applicable Oil and GasTax		$1,764,000	$1,658,000	$3,422,000
Statutory Allocations -- Applicable Portion of Oil and Gas				
Coal Bed Methane Protection			400,000	400,000
Orphan Share Account-50% of Remainder (02472)		**441,000**	0	441,000
Reclamation & Development-50% of Remainder (02458)		**441,000**	0	441,000
TOTAL Oil and Gas STATUTORY ALLOCATIONS		882,000	400,000	1,282,000
Resource Indemnity Trust (09003)-50% of RIGWA & Oil and Gas	1,570,000	1,452,000	0	1,452,000
TOTAL OIL AND GAS STATUTORY ALLOCATIONS	$1,570,000	$2,904,000	$1,551,000	$4,455,000



3

	Fiscal 2001	Fiscal 2002	Fiscal 2003	Biennium Total
RIT Interest Earnings (RATC estimates)	$7,467,000	$7,582,000	$7,609,000	$15,191,000
Priority Statutory Allocations of Interest				
Environmental Contingency Account (02107)**	0	(175,000)	0	(175,000)
Oil & Gas Prod. Damage Mitigation Account (02010)***	0	(50,000)	0	(50,000)
Water Storage Account (02216)	0	(500,000)	0	(500,000)
Groundwater Assessment Account-direct (02289)	(300,000)	(300,000)	(300,000)	(600,000)
MSU-Northern Statutory Appropriation (02272)	(240,000)	(240,000)	(240,000)	(480,000)
Fish, Wildlife, and Parks -- Future Fisheries (02022)	0	(500,000)	**(350,000)**	(850,000)
Renewable Resource Grant & Loan Program (02272)	(2,000,000)	(2,000,000)	(2,000,000)	(4,000,000)
Reclamation & Development Grants (grants) (02458)	(1,500,000)	(1,500,000)	**(1,200,000)**	(2,700,000)
Total Allocations	($4,040,000)	($5,265,000)	($4,090,000)	($9,355,000)
Amount Available for Further Distribution	$3,427,000	$2,317,000	$3,519,000	$5,836,000

Table 1 shows four elements of RIT. The first element shows the RIT revenues and trust balance for the past four fiscal years and Revenue and Taxation Committee (RATC) projections for fiscal years 2001 and 2002. The RATC estimates for 2003 have been adjusted to reflect the current RIT trust balance. As shown, the RIT trust has a current balance of approximately $101.6 million.

4

Table 1 (Continued)

Related Expenditure Accounts **(2003 biennium totals)**	Renewable Resource (02272)	Reclamation & Development (02458)	Hazardous Waste/CERCLA (02070)	Environmental Quality Protect (02162)	Groundwater Assessment (02289)****	Water Storage (02216)	Orphan Share (02472)
Further Distribution % of RIT Interest	30%	35%	26%	9%	0%	0%	0%
Available Fund Balance Beginning FY2002	$990,036	$1,387,805	$516,018	$572,571	$252,454	$727,144	$4,302,508
Prior Year Grant Redutions -- August 2002 Special Session		**$466,752**					
Adjusted Available Fund Balance Beginning FY2002	$990,036	$1,854,557	$516,018	$572,571	$252,454	$727,144	$4,302,508
Revenues (RATC, agency estimates)							
RIT Interest-direct	$4,480,000	$2,700,000			$600,000	$500,000	
RIT Interest-further allocation by above %	1,750,800	2,042,600	1,517,360	525,240			
RIGWAT Proceeds		968,500			666,000		818,500
Metal Mines Tax (7%)		**401,776**					465,448
Leg. Changes 02458 -- HB572, 02458 – HB 572, SB 322, SB 484		(200,000)					(1,017,250)
Sweep of Excess Coal Tax & Interest (from 04011)	120,000						
STIP/Other Interest	160,000		68,000	22,000		10,000	92,000
Cost Recoveries				480,000			
Administrative Fees	26,000					9,000	
State-owned Project Revenue	-	-	-	-	-	225,400	-
Total Revenues	$6,536,800	$5,912,876	$1,585,360	$1,027,240	$1,266,000	$744,400	$358,698
Executive Appropriations							
House Bills 6 and 7 Grants -- $300k Reduclton SS	$4,000,000	**$4,400,741**					
House Bill 6-Emergency/Private Grants	225,000						
MSU-Northern (statutorily appropriated)	480,000						
UM-Bureau of Mines					$1,266,000		
DNRC-Conservation and Resource Devel. Division	682,647	1,264,205					
DNRC-Water Resources Division						500,000	
DEQ-Planning, Prevention & Assistance			$319,593				
DEQ-Enforcement		10,551		9,655			
DEQ-Remediation			500,275	1,744,839			3,552,003
DEQ-Permitting & Compliance		2,968,285	1,056,094				
Governor's Office-Flathead Basin Commission	99,020						
Judiciary-Water Court	1,348,650						
Library Commission-NRIS	379,056	335,467					
House Bill 13 (executive pay plan estimate)	12,615	90,686	42,613	38,707	-	-	-
Total Appropriations	$7,226,988	$9,069,935	$1,918,575	$1,793,201	$1,266,000	$500,000	$3,552,003
Transfer to Reclamation and Development/General Fund		**$1,000,000**					**(1,000,000)**
Projected 2003 Biennium Ending Balance	**$299,848**	**($302,503)**	**$182,803**	**($193,390)**	**$252,454**	**$971,544**	**$109,203**

* Does not include unrealized investment gains or losses

** The governor must report on the expenditures from the environmental contingency account in the executive budget Expenditures are statutorily appropriated

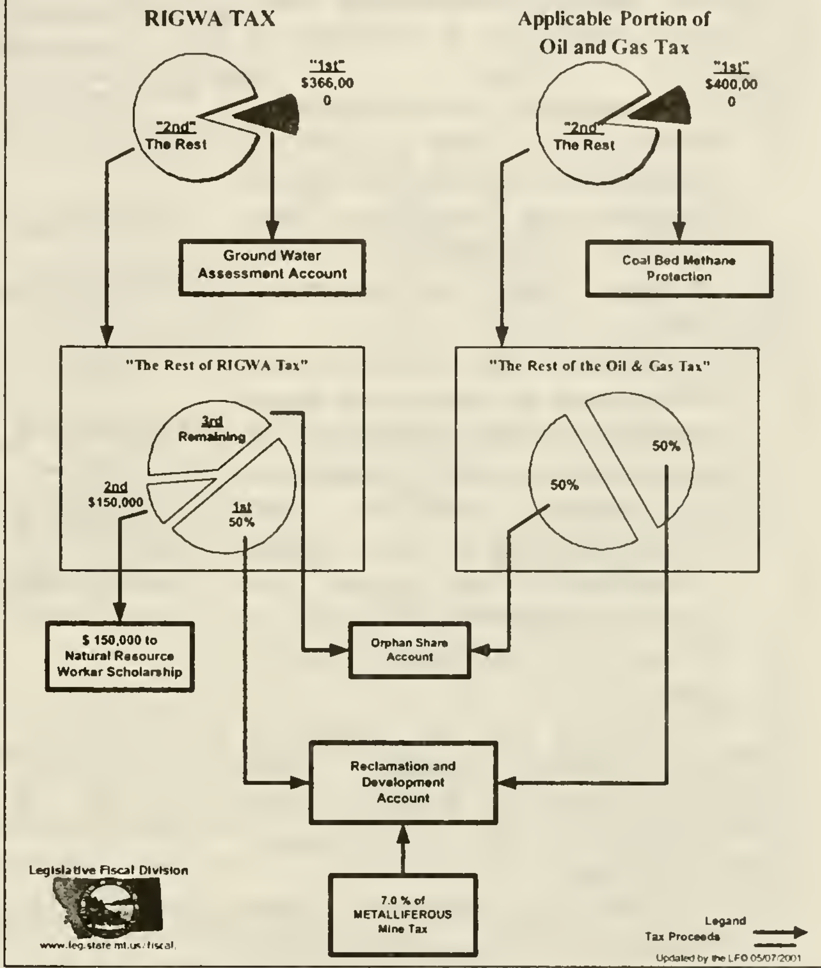
*** Amounts are deposited to the oil & gas production damage mitigation account to bring the balance up to $200,000 (82-11-161, MCA) All money in the account is statutorily appropriated

**** Amounts are deposited to the groundwater assessment account to bring the balance up to $666,000 Any excess goes to the RIT trust (85-2-905, MCA).

The second element shows the statutory allocations of RIGWA and the applicable portion of the oil and gas tax. The RIGWA tax and the applicable portion of oil and gas taxes are distributed to a number of natural resource accounts. After the trust reached $100 million, the RIT funding sources are distributed as follows and illustrated in Figure 1 (as currently distributed -- does not include changes proposed by the executive):

- RIGWA – The first $366,000 is deposited into the ground water assessment account. The remainder is allocated by depositing 50 percent into the reclamation and development account, $150,000 into an account for natural resource worker scholarships, and the remainder into the orphan share account.
- Applicable portion of oil and gas taxes – The first $400,000 of the applicable portion of the oil and gas taxes are deposited into the coal bed methane protection account. The remainder is split between the reclamation and development account and the orphan share account
- Metaliferous mines taxes – 7.0 percent of this funding source is deposited to the reclamation and development account.

Figure 1
Flow of RIGWA and Oil & Gas Tax Proceeds Fiscal 2003
August 2002 Special Session



Trust Interest

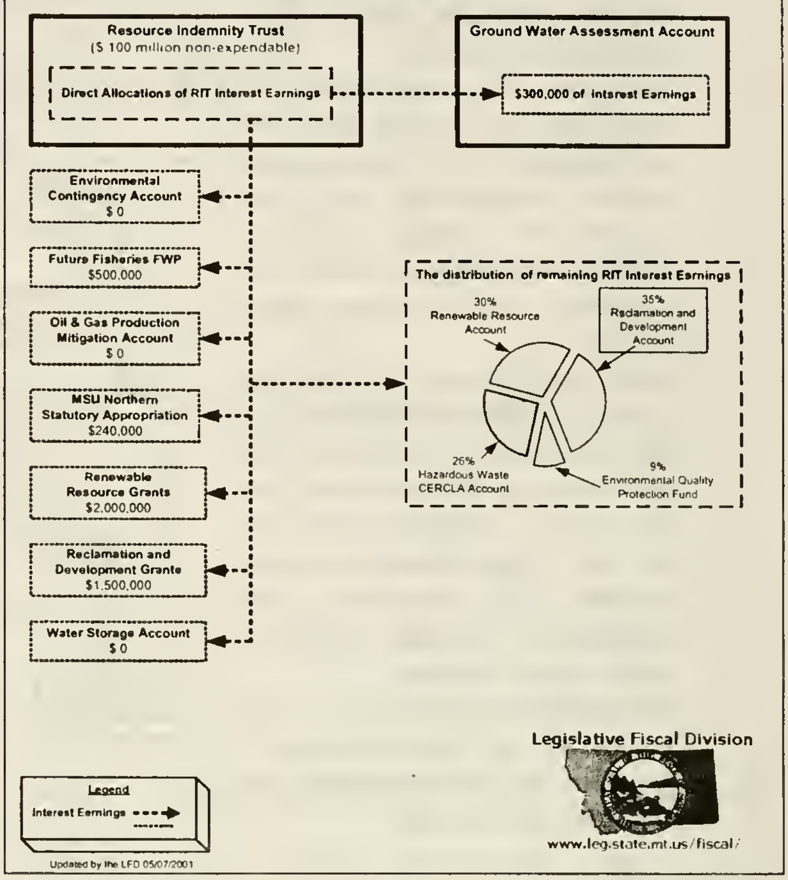
The third element shows the amount of interest generated by the RIT and the amounts that are allocated by statute for specific purposes in the 2003 biennium. 15-38-202 MCA directs how interest from the RIT trust will be allocated. Driven by RATC estimates, $15.2 million of interest is allocated to a number of sources.

The constitution does not restrict the spending of interest from the RIT. For the 2003 biennium, statute allocates $9.8 million of the interest for eight purposes. Figure 2 illustrates the flow of interest from the RIT for fiscal 2003 (as currently distributed -- does not include changes proposed by the executive).

After the direct allocations are made, the fourth element shows seven main accounts that receive RIT interest and other revenues. After direct interest allocations are made, any interest remaining is allocated as follows:

- o 30 percent to the renewable resource account, which funds programs in the Judiciary, Department of Natural Resources and Conservation, State Library Commission, MSU Northern, and the Governor's Office;
- o 35 percent to the reclamation and development account, which funds programs in the Department of Environmental Quality, Department of Natural Resources and Conservation, and the State Library Commission. This account also receives portions of the RIGWA, oil and gas, and metalliferous mines tax proceeds;
- o 26 percent to the hazardous waste/CERCLA account, which funds remediation activities in the Department of Environmental Quality; and
- o 9 percent to the environmental quality protection fund, which funds remediation activities in the Department of Environmental Quality.

Figure 2
Flow of RIT Interest Earnings, Fiscal 2003
August 2002 Special Session



<u>Executive Proposals</u>

As part of the Governor's proposals to bring the state budget into balance for the 2003 biennium, changes have been proposed to the RIT trust balance and to related RIT accounts. Table 2 summarizes the proposed changes. A discussion of each change will follow.

Agency Impacts

DNRC

Reclamation and Development Grant Reduction

In HB9, the Reliance Refinery Soils and Sludge Cleanup grant awarded in 1997 through HB7 will be reduced by $466,752. Since a portion of the work on this project has been completed, $115,548 will remain to pay costs already incurred. This reduction has the effect of increasing the balance in the reclamation and development account.

Table 2
Resource Indemnity Trust (RIT)
Summary of Executive Proposal Impacts to the RIT and Related Accounts
August 2002 Special Session

1			
Projected RIT Trust Balance:			$ 100,396,874
Adjust to actual		$ 500,750	
DNRC -- CARDD Funding Switch		(1,000,000)	
Total Adjustments			$ (499,250)
Total Impact to RIT Trust Balance			$ 99,897,624
2			
Interest Allocations:	**FY 2003 Allocations**	**Reduction**	**Adjusted FY 2003 Allocations**
FWP -- Future Fisheries	$ 500,000	$ (150,000)	$ 350,000
Reclamation and Development	1,500,000	(300,000)	1,200,000
Total Interest Allocation Impacts	$ 2,000,000	$ (450,000)	$ 1,550,000
3			
Other Proposed Changes	**Increases**	**Decreases**	**Affected Fund**
1997 Grant Reductions -- DNRC	$ 466,752		Reclamation and Development
2001 Grant Reduction -- DEQ	300,000		Reclamation and Development
Metal Mines Tax	-	(383,310)	Reclamation and Development
Applicable Portion of Oil and Gas Taxes	-	(629,000)	Reclamation and Development
Applicable Portion of Oil and Gas Taxes		(629,000)	Orphan Share
Orphan Share Account	-	(1,000,000)	Orphan Share
TOTAL	$ 766,752	$ (2,641,310)	

LFD COMMENT The Reliance Refinery is an abandoned oil well on state-owned land. DNRC submitted an Interim Limited Action Work Plan to DEQ last fall, which DEQ subsequently approved. This spring and summer, DNRC has contracted with Land and Water Consulting to conduct the activities described in the work plan. The firm completed a portion of the work plan activities. According to the DEQ remediation staff, there is an immediate and continuing threat to the environment and to public health if this cleanup is not completed since the contamination from the facility will remain and potentially migrate both vertically and laterally. Given the environmental concerns over this site, the legislature may wish to eliminate this reduction.

CARDD – Funding Switch

Because the RIT is capped at $100 million, funds above this amount are available to use for improving the environment and cleanup costs. HB 9 proposes to change 80-7-823 MCA, which would eliminate the transfer of $500,000 of excess RIT balance to be used for the control of noxious weeds. This change makes this funding available for other environment related projects. This $500,000, along with an additional $500,000 of excess fund balance, is proposed by the executive to be transferred through a HB9 amendment into state special revenue funds (reclamation and development and renewable resources accounts) maintained by DNRC. A funding switch in HB2 would reduce the DNRC general fund appropriation by $1 million and increase its state special revenue appropriation by the same amount to utilize the excess RIT transfer. Because the trust has reached $100 million, there are no more funding sources for the RIT trust. Thus, this is a one-time transfer.

LFD ISSUE The executive estimates that after the fiscal year end processing is completed, the fund balance in the RIT trust will reflect a higher amount. If that does not occur, it appears that the transfer would violate Article IX, Section 2 (3) of the Montana Constitution. This section of the constitution guarantees that the RIT trust will not fall below $100 million.

DEQ

Reclamation and Development Grant Elimination

In HB9, the Gregory Mine grant awarded in 2001 through HB7 will be eliminated. This $300,000 elimination has the effect of increasing the fund balance in the reclamation and development account.

LFD COMMENT The Gregory Mine is an abandoned hard rock mine. Funding to complete this project was to come in part from a reclamation and development grant. Funding to complete this project has been secured from the Office of Surface Mining, U.S. Department of Interior. Therefore, this mine will be reclaimed despite the elimination of the HB7 grant.

FWP

HB 9 revises 15-38-202 (2)(v) MCA to reduce the RIT interest allocation for future fisheries projects by $150,000. If approved, FWP would have an RIT interest allocation of $350,000 rather than $500,000 in fiscal 2003 to complete Bull and Cutthroat trout enhancement projects as part of its Future Fisheries program. In addition to the RIT funding, the Future Fisheries program receives funding from the river restoration account and an earmarked portion of the general license account for related projects.

LFD COMMENT The proposed reduction would continue through the 2005 biennium and would have a cumulative effect of $450,000. Interested parties provide matching dollars for Future Fisheries projects. Thus, the department estimates that the cumulative effect may be an additional $180,000 or a total of $630,000 of "on the ground" projects over the three-year period.

<u>Other Impacts</u>

Reclamation and Development Account

The executive is proposing to reduce the interest allocation to the reclamation and development account through HB9. If approved, the account would see a $300,000 interest allocation reduction each fiscal year until the end of the 2005 biennium.

LFD COMMENT As shown in Table 1, the reclamation and development account is used by DNRC, DEQ, and the Library Commission to fund environmental resource projects including reclamation, non-point source pollution, waste cleanup, and NRIS (Natural Resource Information System). Over the three year period of diversion, $900,000 of these types of projects will either not be done or will be done at a slower pace.

Orphan Share

Through an amendment to HB 9, the executive proposes to transfer $1.0 million from the orphan share account into the general fund if, on June 29, 2003, sufficient money remains in the orphan share fund. The current balance in the orphan share account is approximately $4.0 million.

House Bill 10

Two proposals in HB10 would impact some of the RIT accounts that derive income from natural resource taxes. The first is the metal mines tax and the second is the oil and natural gas production tax.

Metal Mines Tax Distribution

The distribution of the metal mines tax was altered several times over the past years. The executive proposes another change in the distribution of the revenues from this source. For fiscal 2003 through 2005, proceeds going into the reclamation and development grant program would be eliminated. Those revenues would now flow into the general fund. The percent of revenues going to the general fund would increase from 58 percent to 65 percent. The executive estimates this to amount to a $411,000 increase to the general fund.

Proposed Changes in Metalliferous Mines License Tax Distributions

Program	Current Law	Executive Proposal	Executive Proposal after 7/1/2005
Hard-Rock Mining Impact Trust Account	2.50%	2.50%	2.50%
Hard-Rock Mining Reclamation Debt Service Fund	8.50%	8.50%	8.50%
Reclamation and Development Grants Program	7.00%	0.00%	7.00%
County Commissioners (for allocation)	24.00%	24.00%	24.00%
Sub-total	42.00%	35.00%	42.00%
General Fund	58.00%	65.00%	58.00%

Oil and Natural Gas Production Taxes

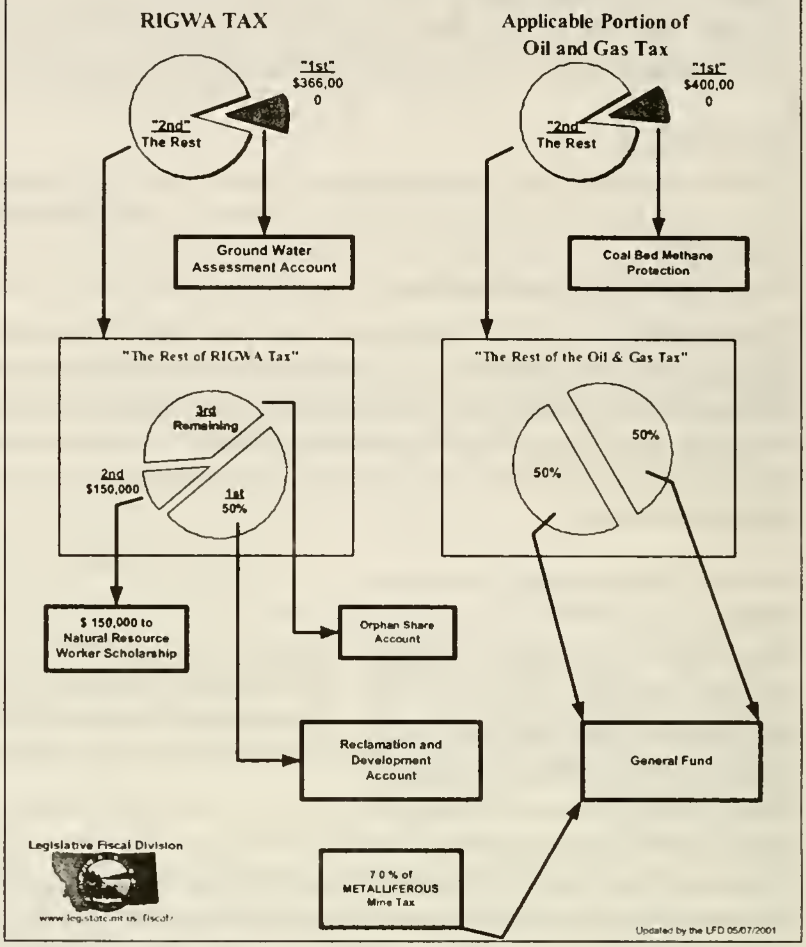
The next executive proposal changes the distribution of oil and natural gas production taxes through fiscal 2005, creating a larger distribution to the general fund. Both oil and natural gas have numerous distribution percentages depending on many factors. The executive proposal eliminates proceeds flowing to the reclamation and development grants special revenue account and the orphan share account through fiscal 2005, and redirects the revenues to the general fund. The executive estimates these additional revenues to the general fund at $1.5 million for fiscal 2003.

Figure 3 shows how the flow of RIGWA and the applicable portion of oil and gas tax proceeds will change if HB10 is approved.

Fund Balances

Of the seven funds that derive income from the RIT, two of them are projected to have a negative balance at the end of the 2003 biennium after executive proposals are taken into account. The reclamation and development account is projected to have a negative balance of $1.3 million while the environmental quality protection fund is projected to have a negative ending fund balance of $193,390. Positive fund balances are projected for the other funds.

Figure 3
Flow of RIGWA and Oil & Gas Tax Proceeds Fiscal 2003
Governor's Proposal



LFD COMMENT The executive has proposed adjustments that will reduce grants, eliminate interest allocations, transfer funds and change the income stream into funds that derive income from RIT tax sources. Although some of these changes are temporary in nature, the impacted funds will see a permanent loss because there is no plan to increase funding. Thus, environmental work that would have been done with the funding used to cover general fund shortfalls will be postponed or cannot be completed.

Weeds Grant Funding from Resource Indemnity Trust (RIT) Excess

This proposal would eliminate a one-time-only transfer of up to $500,000 from the RIT to the Noxious Weed State Special Revenue Account for county weed management district programs. Since this transfer was only for fiscal 2003, the reduction is for fiscal 2003 only.

The 2001 legislature passed SB 326, which, among other things, directed the above transfer from "the first money paid into the Resource Indemnity Trust Fund that exceeds $100 million for the purposes provided in 80-7-705." Although the RIT balance is over $100 million, no funds have been transferred to the Noxious Weed account for fiscal 2003.

LFD COMMENT This transfer was over and above other weed program appropriations, so the net effect on the fiscal 2003 weed management district grants relative to fiscal 2002 will be minimal.

LFD COMMENT Because the RIT is capped at $100 million, funds above this amount are available to use for improving the environment and cleanup costs. HB 9 proposes to change 80-7-823 MCA, which would eliminate the transfer of $500,000 of excess RIT balance to be used for the control of noxious weeds. This change makes this funding available for other environment related projects. This $500,000 along with an additional $500,000 of excess fund balance is proposed by the executive to be transferred through a HB9 amendment into state special revenue funds (reclamation and development and renewable resources accounts) maintained by DNRC. For a further discussion of the impacts to the RIT, see the RIT discussion.

Ongoing? No. Original transfer was one-time-only. Reduction can only take place in fiscal 2003.

<u>Language Requested</u>

"The special session elimination of this appropriation is contingent on the passage and approval of HB 9, August 2002 Special Session."

Lodging Facility Use Tax (Bed Tax)

This proposal would revise language within House Bill 2 to increase the relative amount of bed tax provided by the Department of Commerce to other programs, in addition to providing a statutory appropriation to the Montana Arts Council (MAC). This funding would replace general fund currently appropriated to those programs. This proposal will only reduce the amount of bed tax collections available to the Montana Promotion Division, and will not affect the statutory amounts to other entities, including regional convention and visitors' bureaus.

Currently, bed tax collections are statutorily appropriated to several departments, including the Department of Commerce, which uses the allocation to fund the Montana Promotions Division (Travel Montana). The 2001 legislature included language in House Bill 2 specifying the legislature's intent that the Department of Commerce provide funding out of its 67.5 percent allocation to the Montana Historical Society (MHS) for programs within the MHS ($511,677 in fiscal 2003).

The executive proposes increasing the current $511,677 allocation to the MHS by $861,917, as follows:

MHS Museum Program	$289,390
MHS Historic Sites	$ 59,829
MHS Library-Archives Program	$461,192
MHS Publications	$ 51,506

The proposal also specifies intent that the Department of Commerce provide funding for the following programs in the Department of Fish, Wildlife, and Parks (FWP), the MAC, and the Museum of the Rockies:

FWP Parks Division	$257,707
MAC Folklife Program	$ 56,800
Museum of the Rockies	$515,000

Additionally, the proposal revises statute to replace $223,575 general fund in the MAC with bed tax funding from the Department of Commerce allocation.

LFD COMMENT The 2001 legislature appropriated $223,575 of general funds for the Cultural and Aesthetic (C&A) grants program in fiscal 2003. The appropriation replaces grant funds, which have been negatively effected by the C&A Trust's reduced interest earnings. The proposed fund switch changes the source of funding from the general fund to the bed tax. The switch will have no adverse effect on the amount of grants issued in the Cultural and Aesthetic Grant program.

Total funding switches from general fund to bed tax total approximately $1.9 million. The table below shows fiscal 2002 data and proposed fiscal 2003 allocations using fiscal 2002 collections as a baseline.

LFD COMMENT Per the Montana Promotions Division, a portion of the reduction can be absorbed in the current fund balance. However, the planned purchase of Customer Relations Management software for a planned call center will be at least delayed temporarily, if not indefinitely. Additionally, depending on fiscal 2003 bed tax revenues, other programs within the Division may be reduced, although at this time, those programs and the extent to which they may be affected is undetermined.

LFD COMMENT Although the House Bill 2 language specifying legislative intent has been complied with in the past, it does not in itself legally compel the Department of Commerce to comply with the language. The over-riding allocation is the original statutory appropriation of 67.5 percent of the bed tax funds remaining after the off-the-top allocations are removed.

Lodging Facility Use Tax Current and Proposed Allocations

Current Law (Fiscal 2002)

Current Tax Percentage:	4.00%		
Fiscal 2000 Bed Tax Revenue:	$11,720,557		
Off-the-top Allocation:			
Department of Revenue:		$	126,368
Reimbursements for State Empl:		$	143,205
Heritage Preservation & Devel.:		$	400,000
Total		$	669,573
Remaining Amount for % Allocations:			$11,050,984
Current Percentage Allocations:			
Department of Commerce:	67.5%	$	7,459,414
Regional Nonprofit Tourism Corps:	22.5%	$	2,486,471
Fish, Wildlife and Parks:	6.5%	$	718,314
Commissioner of Higher Education:	2.5%	$	276,275
Montana Historical Society:	1.0%	$	110,510
Total:	100.0%	$	11,050,984
Out of Dept of Commerce Statutory Appropriation (67.5%)			
HB2 "intent" language requests Dept of Commerce provides the following funds:			
Montana Historical Society			$515,961
(Fiscal 2003 language provides $511,677)			
Actual Dept of Commerce Allocation:			$6,943,453

FY2003 Special Session Proposal
(Using 2002 Collections)

Current Tax Percentage:	4.00%		
Fiscal 2000 Bed Tax Revenue:	$11,720,557		
Off-the-top Allocation:			
Department of Revenue:		$	126,368
Reimbursements for State Empl:		$	143,205
Heritage Preservation & Devel.:		$	400,000
Total		$	669,573
Remaining Amount for % Allocations:			$11,050,984
Current Percentage Allocations:			
Department of Commerce:	67.5%	$	7,459,414
Regional Nonprofit Tourism Corps:	22.5%	$	2,486,471
Fish, Wildlife and Parks:	6.5%	$	718,314
Commissioner of Higher Education:	2.5%	$	276,275
Montana Historical Society:	1.0%	$	110,510
Total:	100.0%	$	11,050,984
Out of Dept of Commerce Statutory Appropriation (67.5%)			
Fund switch - Montana Arts Council			$223,575
HB2 "intent" language requests Dept of Commerce provides the following funds:			
Montana Historical Society			$1,372,594
FWP			$257,707
Montana Arts Council			$56,800
Museum of the Rockies			$515,000
Actual Dept of Commerce Allocation:		$	5,033,738

Ongoing? No. As proposed, the $223,575 statutory appropriation to the MAC is only for fiscal 2003, and the House Bill 2 revisions will only affect fiscal 2003. To make this funding switch ongoing, the legislature will have to provide another appropriation to the MAC for subsequent biennia, and House Bill 2 legislative intent language will have to be added for each subsequent biennia. Another option would be to revise 15-65-121 MCA to permanently reallocate Bed Tax revenues.

Language Requested

Department of Fish, Wildlife, and Parks – "It is the intent of the legislature that the Department of Commerce use Lodging Facility Use Tax to fund $257,707 in fiscal year 2003 for the Department of Fish, Wildlife, and Parks. This would be expended in the parks program for tourism-related purposes. "

Department of Commerce - "It is the intent of the legislature that the department use Lodging Facility Use Taxes to fund $515,961 in fiscal year 2002 and ~~$511,677~~ $2,203,102 in fiscal year 2003 for the Montana Historical Society, the Department of Fish, Wildlife, and Parks, the Montana Arts Council, and the Museum of the Rockies. This would be expended as follows:

	2002	2003
MHS Lewis and Clark Bicentennial	$116,477	$111,124
MHS Scriver Curator	28,484	25,553
MHS Scriver Rent Storage	96,000	100,000
MHS Lewis and Clark Bicentennial Commission	200,000	200,000
MHS Historical Interpretation	75,000	75,000
FWP Parks Division	0	257,707
MHS Museum Program	0	289,390
MHS Historical Sites	0	59,829
MHS Library Archives Program	0	461,192
MHS Publications	0	51,506
MAC Folklife Program	0	56,800
Museum of the Rockies	0	515,000"

Montana Arts Council – "In item 1, it is the intent of the legislature that the Department of Commerce use Lodging Facility Use Taxes to fund $56,800 in fiscal year 2003 for the Montana Arts Council. This would be expended for the Folklife program."

Montana Historical Society – "It is the intent of the legislature that the Department of Commerce use Lodging Facility Use Taxes to fund $515,961 in fiscal year 2002 and ~~$511,677~~ $1,373,594 in fiscal year 2003 for the Montana Historical Society. This would be expended as follows:

	2002	2003
Lewis and Clark Bicentennial	$116,477	$111,124
Scriver Curator	28,484	25,553
Scriver Rent Storage	96,000	100,000
Lewis and Clark Bicentennial Commission	200,000	200,000
Historical Interpretation	75,000	75,000
Museum Program	0	289,390
Historical Sites	0	59,829
Library Archives Program	0	461,192
Publications	0	51,506"

Montana University System – "Item 7 includes $515,000 of state special revenue in fiscal year 2003 for Lodging Facility Use Taxes from the Department of Commerce to fund the Museum of the Rockies."

Motor Vehicle Division

For fiscal 2003, the executive proposes an $8.337 million funding switch in the Motor Vehicle Division of the Department of Justice from general fund to highways state special revenue.

LFD COMMENT

Restriction on Use of Highways State Special Revenue Funds

The portion of this proposal referring to the restricted highway state special revenue account is governed by Article VIII, Section 6, Constitution of Montana. This section, titled highway revenue non-diversion, specifies the revenues that are constitutionally guarded and the allowable uses of these guarded revenues. The constitution states, "(1) Revenue from gross vehicle weight fees and excise and license taxes (except general sales and use taxes) on gasoline, fuel, and other energy sources used to propel vehicles on public highways shall be used as authorized by the legislature, after deduction of statutory refunds and adjustments, solely for:

> (a) Payment of obligations incurred for construction, reconstruction, repair, operation, and maintenance of public highways, streets, roads, and bridges.
>
> (b) Payment of county, city, and town obligations on streets, roads, and bridges.
>
> *(c) Enforcement of highway safety, driver education, tourist promotion, and administrative collection costs."*

However, the constitution does allow these guarded revenues to be appropriated for other purposes by a three-fifths vote of the members of each house of the legislature.

The 1997 legislature reduced the level of highways state special revenue account (HSSRA) support in the Motor Vehicle Division by $1.5 million for the 1999 biennium and replaced it with general fund due to the structural imbalance of HSSRA. In addition, the 1997 legislature enacted HB 610 to provide a comprehensive review of highway funding. This study was conducted by a subcommittee of the Legislative Finance Committee and reviewed the use of HSSRA funding for activities of the Motor Vehicle Division. The study identified functions funded by HSSRA that did not meet the constitutional provision and recommended that this funding should be switched to general fund. The 1999 legislature approved reducing HSSRA by $2.1 million in the Highway Patrol Division and increasing general fund by a like amount for the 2001 biennium.

In the 2003 biennium, $37.7 million of HSSRA funds were appropriated to the Department of Justice, with $0.9 million of that amount appropriated to the Motor Vehicle Division Field Operations Bureau. The Motor Vehicle Division is currently supported by approximately 90 percent general fund. However, this proposal would eliminate all general fund. Because of the division's connection to the motoring public, HSSRA funds have in the past been increased as a funding source to relieve the general fund.

The legislature should be aware of these constitutional restrictions when switching funding to the restricted portion of the HSSRA. It should either verify the functions satisfy the conditions for use of these revenues or only allow the funding switch if the three-fifths vote requirement is met. One way to assure that the functions proposed to be funded by the restricted portion of the account satisfy the guidelines would be to have the executive provide details on how the funds would be spent in support of the constitutional restrictions.

LFD COMMENT (Cont.)

Impact of Prior Reductions

As a part of the 17-7-140, MCA, general fund spending reductions, the Governor proposed reducing the transfers from the general fund to the non-restricted account for the 2003 biennium. The biennium impact of these reductions is a $5.79 million lower fund balance at the end of the 2003 biennium. This statutory transfer requires legislative action to complete (see HB5, 2002 special session).

Summary of Working Capital Analysis
Highways State Special Revenue Account
Fiscal Years 2002-2007
(in millions)

	Fiscal 2002*	Fiscal 2003**	Fiscal 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007
Beginning Balance	$ 40.87	$ 47.34	$ 25.57	$ 22.42	$ 14.29	$ 12.82
Revenues	220.00	218.85	221.08	223.57	226.03	228.64
Expenditures:						
Department of Transportation (MDT)	(170.96)	(192.10)	(185.50)	(189.00)	(184.80)	(188.20)
Local Assistance	(16.79)	(16.79)	(16.79)	(16.79)	(16.79)	(16.79)
Department of Justice (DOJ)	(17.54)	(19.11)	(19.66)	(20.22)	(20.80)	(21.40)
HB5 Long-Range Building Program:						
MDT Facilities	(1.90)	(3.37)	(2.50)	(2.50)	(2.50)	(2.50)
Fish, Wildlife, and Parks Facilities	(0.73)	(1.82)	(0 20)	(0.20)	(0.20)	(0.20)
Other Considerations						
MDT indirect cost allocation plan	5.00	5.00	5.00	5.00	5.00	5.00
MDT broadband pay plan	(Note 1)	(0.89)	(0.93)	(0.96)	(1.00)	(1.04)
Alcohol tax incentive			(3.21)	(5.25)	(5.25)	(5.25)
Ethanol use incentive				(0.59)	(Note 2)	(Note 2)
Reduce general fund transfer (HB5 Aug. 02)	(2.87)	(2.84)				
2-day furlough		0.42				
Fund Motor Vehicle Division in DOJ		(8.34)				
Interest effects of other considerations	(0.09)	(0.20)	(0.06)	(0.14)	(0.12)	(0.12)
Ending Balance	$ 47.34	$ 26.44	$ 23.31	$ 15.20	$ 13.74	$ 10.98
Structural Balance (Imbalance)	6.47	(21.77)	(3.15)	(8.13)	(1.47)	(2.77)

Note 1: Broadband pay plan expenditures are in current level actual expenditures for fiscal 2002
Note 2: Reduced balance would stop this incentive
* Fiscal 2002 numbers reflect preliminary values prior to fiscal year closing
** Fiscal 2003 numbers reflect HJR2 revenue estimates and all valid unexpended biennial and continuing appropriations

LFD COMMENT (Cont.)

Highways State Special Revenue Account Stability

This funding switch proposal would have minimal short-term impacts on highway construction and maintenance activities, since the main impact is a reduction of the HSSRA working capital balance. Based on preliminary data for fiscal 2002, estimated revenues and expenditures for fiscal 2003 and the 2005 biennium, and the impacts of HB5, the ending working capital balance for HSSRA would be $47.3 million in fiscal 2002 and $23.7 million at the end of the 2005 biennium without this proposal. The above table shows that with this funding switch proposal and a 2-day furlough, the working capital balance would be reduced to $15.2 million at the end of the 2005 biennium. A $15.2 million working capital balance would equate to roughly 18 days of account expenditures. This level could potentially provide cash flow problems.

Ongoing? No. With existing expenditure patterns of functions currently funded by the account and the addition of $8.3 million each year to fund the Motor Vehicle Division, the HSSRA working capital balance would be fully depleted during the 2005 biennium. Continued erosion of HSSRA would soon begin to impact highway construction and maintenance activities and may lead to an inability to match federal funding or could jeopardize Montana's maintenance of effort on federal-aid highways, which could lead to a higher state match percentage to receive federal highway funds.

HB2 Language Requested

"Item 3 special session changes reduce general fund in fiscal year 2003 by $8,240,751 and increase state special revenue in fiscal year 2003 by $8,336,799. The increased amount includes the House Bill No. 13 allocation, the governor's 17-7-140 MCA reductions, House Bill No. 2 agency-wide reductions of travel and 1% general fund vacancy savings. Of the state special revenue, $4,147,027 will come from the restricted highway state special revenue account and $4,189,772 will come from the non-restricted highway state special revenue account."

Employment Security Account Fund Switch

This proposal replaces $4.0 million in general fund appropriations within the Departments of Labor and Industry, Military Affairs, and Public Health and Human Services (DPHHS) with state special revenue appropriations from the Employment Security Account (ESA) administered by the Department of Labor and Industry. In turn, $4.0 million in ESA funding in the Department of Labor and Industry will be replaced with a like amount of the state's one-time distribution of Reed Act funding from the federal Department of Labor. The affected programs, and the amount of the $1-for-$1 fund switch between the ESA and general fund are included in the table below.

LFD COMMENT On March 13, 2002 the federal Department of Labor authorized an $8 billion distribution to states' accounts in the Unemployment Trust Fund. Montana's share was $18,551,627. In a May 8, 2002 letter, the federal Department of Labor stated "This distribution gives states an opportunity to make significant improvement in unemployment insurance (UI) and employment service (ES) operations in areas where grant funds have not been sufficient." This letter also listed suggested uses for the Reed Act funding, including:

- Revolving funds for UI and ES automation,
- UI and ES performance improvement,
- Reducing UI fraud and abuse,
- Improvement in UI claims filing and payment methods, and
- One-Stop administration.

The intent of this proposal is to replace $4.0 million in ESA funds within the Department of Labor and Industry with Reed Act funds where appropriate. This will in turn free up ESA funding, which has no statutory limitations on its use, for other uses across state government. Revenues into the ESA come from a 0.013 percent allocation of the Unemployment Tax paid by Montana Employers as prescribed by 39-51-404 MCA. At this time the programs participating in the ESA/Reed Act fund switch have not been specifically identified.

Disability Services – ESA Funds

The executive proposal includes a transfer of almost $2 million state special revenue from the ESA to the Disability Services Division (DSD) in DPHHS and a reduction in general fund appropriations of a like amount. DSD staff indicated that this state special revenue would be used to replace general fund supporting Extended Employment and Vocational Rehabilitation, Section 110, services. Extended Employment services are supported 100 percent by general fund and this transfer would replace all general fund support for that program with state special revenue. The Vocational Rehabilitation, Section 110 program is funded by a combination of general fund and federal funds (19 percent general fund, 81 percent federal funds). Under the executive proposal, a portion of the general fund supporting this program would be replaced by state special revenue. The Vocational Rehabilitation, Section 110 program requires that the funds used as match for federal funds be unrestricted in use. According to Department of Labor and Industry staff, there are no statutory or administrative rule provisions specifying or restricting how ESA funds are used.

General Fund Replaced by Funding		
Agency/Program	Fiscal 2003 GF Approp	Proposed Fund Switch
Labor and Industry		
Jobs for MT Graduates (1)	534,151	532,988
State Job Registry (2)	37,144	18,808
Displaced Homemakers (3)	237,908	219,765
Apprenticeship and Training	140,000	140,000
Total, Labor and Industry	**$949,203**	**$911,561**
Military Affairs		
Youth Challenge (4)	1,158,043	1,123,240
Total, Military Affairs	**$1,158,043**	**$1,123,240**
DPHHS		
Extended Employment Services	782,935	782,935
Vocational Rehabilitation, Section 110	1,182,264	1,182,264
Total, DPHHS	**$1,965,199**	**$1,965,199**
Total Fund Switch		**$4,000,000**

1,2,3,4 - Fund Switch in House Bill 2 includes pay plan allocation
1,2,3,4 - Remaining general fund will not be spent due to Gov. Martz' reductions and statutory requirement to expend non-general fund first.

Ongoing? No. House Bill 2 revision will only affect fiscal 2003. Reed Act funding is not consistent in future years.

HB2 Language Requested

Department of Public Health and Human Services – "Item 8 includes a $1,965,199 general fund decrease in fiscal year 2003 for the Disability Services Division replaced by a like amount of Employment Security Account state special revenue funds administered by the Department of Labor and Industry."

Department of Labor and Industry – "Item 1 includes a $672,609 reduction in general fund money for fiscal year 2003 for the Job Service Division replaced by Employment Security Account state special revenue funds in the amount of $691,796 administered by the department. The increased amount includes the House Bill No. 13 allocation. Item 1 also includes a $4,000,000 reduction in the Employment Security Account state special revenue funds replaced by Reed Act federal special revenue funds."

"Item 1c includes a $217,182 reduction in general fund money for fiscal year 2003 for the Displaced Homemaker Program to be replaced by Employment Security Account state special revenue funds in the amount of $219,765 administered by the department. The increased amount includes the House Bill No. 13 allocation."

Department of Military Affairs – "Item 2b includes a $1,083,359 reduction in general fund money in fiscal year 2003 for the Youth Challenge program replaced by Employment Security Account state special revenue funds in the amount of $1,123,240, which are administered by the Department of Labor and Industry. The increased amount includes the House Bill No. 13 allocation."

Public School Reductions

Reduce School Flexibility Fund Distribution – SB 390, passed during the 2001 legislative session, appropriated $5.0 million for transfer to the state special flex fund account in fiscal 2003. The amount in the flex fund including interest is to be distributed to school districts in October 2002. The executive proposes to reduce this transfer by $4.6 million. The executive had already proposed reducing the flex fund transfer by $184,000 under the authority granted the Governor under 17-7-140, MCA. This will leave $384,000 in appropriation authority in the flex fund. This authority will be under spent by $184,000.

The executive proposes that the Office of Public Instruction (OPI) use the remaining $200,000 to pay for Board of Education testing in fiscal 2003. The executive proposes adding the following language to HB 2:

> "It is the intent of the legislature that item 2q shall be used to pay for costs that would otherwise be incurred by districts to meet the Board of Public Education student testing requirements."

OPI transferred $4.8 million to the state special school flexibility fund at the beginning of fiscal 2003, and therefore, the amount in the fund will collect interest until it is transferred back to the general fund. In order to make sure that the general fund receives this interest, the executive proposes the following language for HB 2.

> "Any cash balance remaining in the School Flexibility Account must be transferred to the general fund by June 30, 2003."

LFD COMMENT SB 390 allowed districts to match up to 25 percent of their flex fund allocation with voted levy revenue. Nineteen districts voted for such levies in June 2002. The language in SB 390 appears to allow these school districts to spend the levy revenue in spite of the fact the districts will not receive flex fund revenue from the state under the executive proposal.

Temporarily Redirect Timber Harvest for Technology Funds – The 2001 legislature authorized that school land timber revenues in excess of that collected on 18 million board feet be deposited in the state special Timber Harvest for Technology account. The legislature also authorized a statutory appropriation to spend these revenues.

The executive proposes depositing timber revenue in the common school interest and income account that ultimately flows into the general fund. The diversion would be temporary and would affect timber receipts in fiscal 2002 and 2003. Since OPI distributes this money one year after its receipt, the timber for technology distributions to districts would be eliminated for fiscal 2003 and 2004.

The Department of Natural Resources and Conservation estimates that the revenue received in fiscal 2002 was $1.2 million and in fiscal 2003 will be $1.1 million. Increased total general fund revenue from this proposal will be $2.3 million for the 2003 biennium.

Reduce Direct State Aid and Increase Guaranteed Tax Base Aid. – The executive proposes reducing the direct state aid percentage by 0.3 percent, from 44.7 percent to 44.4 percent, while increasing the Guaranteed Tax Base aid portion of the district BASE budget from 35.3 percent to 35.6 percent. The net savings to the state is $1.2 million in fiscal 2003.

LFD COMMENT	Local district property taxes will increase by $1.2 million during fiscal 2003.

Higher Education Reduction

The Governor proposes a 3.5 percent general reduction for the Montana University System with an allowance compensating for the proposed reduction in the six-mill levy revenue. In addition, the Governor proposes shifting the funding for the Museum of the Rockies to the Lodging Facility Use Tax on a one-time basis (also discussed under "Lodging Facility Use Tax" page 70). The table below summarizes the Governor's proposal.

Governor's Proposal to the Special Legislative Session
Montana University System General Operating Budgets
(millions)

Description	General Fund	Other State Funds	Net Impact
General Reduction (HB2)	($3.40)	$0.00	($3.40)
Allowance compensating for 6-mill levy reduction	0.21	(0.21)	0.00
Net General Reduction (HB2)	($3.19)	($0.21)	($3.40)
Fund Switch Museum of the Rockies	(0.52)	0.52	0.00
Net HB2 Changes	($3.71)	$0.31	($3.40)
Pay Plan Reduction (HB13)	(1.75)	0.00	(1.75)
Total Reduction - General Operating Budget	($5.46)	$0.31	($5.15)

LFD COMMENT In addition to the proposed $5.5 million general fund appropriation reduction, previous Governor-directed general fund expenditure reductions for the Montana University System total $5.2 million for fiscal 2003. The table below summarizes the original fiscal 2003 general fund appropriation, previous adjustments and expenditure reductions ordered by the Governor, the proposed general fund appropriation reduction for consideration by the special session, and the revised general fund available to the Montana University System. As shown on the table on the following page, cumulative general fund reductions total 7.2 percent of the original fiscal 2003 appropriation.

LFD COMMENT (Cont.)

Fiscal 2003 General Fund Reductions
Montana University System

Description	Original Appropriation	Agency Adjustments**	Jun-02 GF Expend. Reductions	SpecSess Gov Proposal***	Revised Appropriation	Total Percent Reduction
HB 2 - General Appropriations						
Lump Sum:						
CHE-Administration	$1,243,480	($36,360)	($53,930)	($29,996)	$1,123,194	-9.7%
Student Assistance	8,477,208		(144,417)	(204,491)	8,128,300	-4.1%
Talent Search	93,349	(1,464)			91,885	-1.6%
Perkins	78,746				78,746	0.0%
Board of Regents	43,631				43,631	0.0%
Distance Learning	200,000		(7,000)		193,000	-3.5%
Family Practice Residency	341,200		(11,942)		329,258	-3.5%
State Support per Resident	5,000,000		(4,058,013)		941,987	-81.2%
Education Units	99,771,788	99,444		(2,934,796)	96,936,436	-2.8%
Sub-total Lump Sum	115,249,402	61,620	(4,275,302)	(3,169,283)	107,866,437	-6.4%
Line Items:						
Community Colleges	$5,679,546		($212,531)	($131,591)	$5,335,424	-6.1%
Yellow Bay (Res/Bien/OTO)	100,000		(3,500)		96,500	-3.5%
Tribal College Assistance*	100,000		(3,500)	(1,084)	95,416	-4.6%
Ag Experiment Station	9,866,810	(69,841)	(379,808)	(235,162)	9,181,999	-6.9%
Biobased Products Institute	200,000				200,000	0.0%
Extension Service	4,102,993	(29,603)	(161,824)	(100,195)	3,811,371	-7.1%
MT Beef Network (Res/Bien/OTO)	90,000				90,000	0.0%
Bureau of Mines	1,538,621		(57,085)	(35,345)	1,446,191	-6.0%
Forestry Conservation	900,784		(33,496)	(20,804)	846,484	-6.0%
Fire Services	507,250		(18,631)	(11,536)	477,083	-5.9%
Sub-total Line Items	23,086,004	(99,444)	(870,375)	(535,717)	21,580,468	-6.5%
TOTAL HB 2	$138,335,406	($37,824)	($5,145,677)	($3,705,000)	$129,446,905	-6.4%
HB 13 Pay Plan	8,759,051			(1,751,810)	7,007,241	-20.0%
HB 395 Dental Hygiene (Biennial)	119,683		(4,189)		115,494	-3.5%
Statutory Approp-Coop Dev Center	65,000		(2,275)		62,725	-3.5%
GRAND TOTAL	$147,279,140	($37,824)	($5,152,141)	($5,456,810)	$136,632,365	-7.2%

*Biennial appropriation of $100,000 is recorded in HB2 in FY02.

**Net negative adjustment due to transfer of FY03 appropriation to FY02

***$515,000 of the reduction is proposed to be offset by a like amount from the lodging tax.

LFD ISSUE

The primary questions are:

a. How will these general fund reductions be implemented?
b. What will be the impact of implementing the general fund reductions?

Constitutional Roles

The legislature's primary role with regard to university system funding is to exercise its constitutional power to appropriate. As previously noted, the Governor proposes a general fund reduction for the Montana University System for fiscal 2003 of $5.46 million. The legislature will ultimately determine whether to adopt the Governor's recommendation, to approve a different amount, or to make no reduction. Once the legislature establishes the appropriation, or makes changes to the appropriation in special session, the Board of Regents has the constitutional authority and responsibility to decide how to implement the budget and any budget changes.

Options Considered by the Board of Regents

At the July 2002 Board of Regents meeting, the board discussed its options for implementing the Governor's general fund expenditure reduction as well as the Governor's proposal to the special session to reduce general fund appropriations. Options discussed can be categorized into three general areas:

a. Expenditure reductions
b. Use budget reserves to offset reductions (for financial management purposes, the Board of Regents requires the campuses to earmark a portion of the budget as a reserve for enrollment fluctuations)
c. Increase student tuition and fees to offset reductions

The board approved measures from all option categories to implement the Governor's general fund expenditure reductions at its July 2002 meeting. Approximately $2.4 million (47 percent) of the June 2002 general fund expenditure reductions of $5.2 million will be actual expenditure reductions. The remaining $2.75 million of the general fund expenditure reductions will be offset with budget reserves ($.89 million, or 17 percent) and increased student tuition and fees ($1.83 million, or 36 percent). The approved tuition and fee increase translates into an average annual $58 increase from fiscal 2003 tuition rates approved by the Board of Regents in May 2001.[6]

The board will evaluate options to address any additional general fund reduction approved by the August 2002 special legislative session at its September 2002 meeting.

[6] The $58 per student FTE increase is calculated by dividing the approved $1,833,002 tuition increase by 31,443 estimated 2002-03 student FTE. The fiscal 2003 weighted average tuition and mandatory fee rate for resident undergraduates for all campuses before the fiscal 2003 general fund reduction was $3,612 annually. The fiscal 2002 weighted average tuition and mandatory fee rate for resident undergraduates for all campuses was $3,296 annually.

LFD ISSUE (Continued)

Board of Regents Action

At the July 2002 meeting, the board approved a motion that limits the amount of general fund reductions that can be offset with tuition and fee increases. The Board of Regents directed the Montana University System to offset no more than one-half of the total general fund reductions (the Governor's general fund expenditure reduction ordered in June 2002 plus any additional general fund appropriation reductions authorized by the special session) with increased student tuition and fees. For example, if the total general fund reduction is $10 million, no more than $5 million may be offset by increased tuition and fees.

LFD COMMENT

If the legislature adopts the Governor's proposals for the Montana University System in the special session and the Board of Regents ultimately approves the recovery of one-half of the combined general fund reductions through tuition and mandatory fee rate hikes, assuming there are no additional budget reserves available, actual expenditure reductions would amount to approximately $3.9 million, or 37 percent of the combined general fund reductions, and 2.6 percent of the original fiscal 2003 general fund general operating appropriations for the Montana University System. In addition, the fiscal 2003 tuition and mandatory fee rates would increase on average $169 per student FTE for the year from fiscal 2003 tuition rates approved by the Board of Regents in May 2001.

Ongoing? Since it is unknown at this time how the Board of Regents will implement any general fund appropriation reduction approved by the special legislative session, it is not possible to evaluate the permanency of management choices. However, given the state general fund outlook for at least the next biennium, it is likely that student tuition and fee "surcharges" implemented in fiscal 2003 would remain through at least 2005. Expenditure reductions would also likely be ongoing unless the Board of Regents authorizes significant tuition and fee increases in the 2005 biennium.

Two-Day Furlough for Non-Critical Positions

The executive proposes to require state employees to take two days of unpaid leave during fiscal 2003. All branches of government and all funding sources would fall under the requirement. Estimated savings are $1.053 million general fund and $2.179 million other funds (including non-budgeted proprietary funds) in fiscal 2003. The executive is proposing to reduce funding in the pay plan, which means that the approving authority[7] would allocate fewer funds to implement the state pay plan in order to generate the total savings. According to the Office of Budget and Program Planning, agencies will be required to furlough employees even if other measures would reduce personal services by a like amount.

Certain positions would be exempt, including:

- Judges and employees of the Judicial Branch
- Appointed members of boards and commissions
- County assessors and their chief deputies
- School for the Deaf and Blind contracted academic and professional personnel and live-in house-parents
- Contracted academic and professional administrative personnel in the Montana University System
- The executive director and employees of the State Compensation Insurance Fund (State Fund)
- Elected state, county, and city officials
- School teachers
- Persons contracted as independent contractors or hired under personal services contracts already excluded in law
- Critical positions identified by the approving authority, such as (but not limited to)
  - Critical positions at any institution
  - Emergency services
  - Positions necessary to run critical functions and services

LFD COMMENT

Financial Impact to State Employees

- Each state employee would receive a reduction in pay equal to 0.77 percent of total salary, or an average of about $270 per employee. Employees would not lose any benefits, such as sick and annual leave, or medical coverage.
- State employees will receive a 4 percent pay increase partway into fiscal 2003. Applying this reduction to that increase yields a reduction of 0.8 percent, for an effective pay plan increase of 3.2 percent.

Impact to Agencies

Impacts to agencies or services to the public are difficult to gauge. While the two-day furlough itself is not likely to have significant impact on "non-critical" functions or overall efficiency, the impacts of other actions to reduce personal services appropriations could be exacerbated by the furlough. Potential impacts are:

- Work will have to be performed through overtime or compensatory time
- Agencies could have to determine if any services to the public will be impacted.

[7] The Governor or their designated representative for the Executive Branch, the Board of Regents for the Montana University System, the Supreme Court for the Judiciary, the Speaker of the House for the House of Representatives, the President of the Senate for the Senate, the Legislative Finance Committee for the Legislative Fiscal Division, the Legislative Council for the Legislative Services Division, and the Legislative Audit Committee for the Legislative Audit Division.

LFD COMMENT (Cont.)

Neither of these impacts is foreseeable or ensured. For a further discussion of the potential impacts of all personal services reductions, see the narrative entitled "Personal Services Funding Reduction - Cumulative Impact" on page 91.

Allocation of Reductions to Agencies

The executive has stated they plan to request adjustment of the pay plan appropriation in HB 13 from the regular session (HB 3 from the special session) to fund this reduction. Therefore, the Office of Budget and Program Planning will reduce the allocation of funding from that appropriation by the amount calculated in savings for an individual agency. For a further discussion, see the issue below.

For a discussion of the cumulative impacts of this and the other measures either taken or proposed to reduce personal services, see the discussion entitled "Personal Services Funding Reduction - Cumulative Impact" on page 91.

Positions Applied Against

As stated, all state employees not specifically exempted must be furloughed, with the exception of employees in positions identified as "critical" by the approving authority, or performing critical functions. The executive exempted a number of positions from the reductions allocated to individual agencies, including:

1) Elected officials
2) Teachers at the state institutions and the School for the Deaf and Blind
3) Registered nurses and nursing services managers
4) Licensed practical nurses
5) Probation and parole officers; and correctional officers, managers, and supervisors
6) Drill instructors (Department of Corrections)
7) Cottage life attendants and supervisors, and food service workers

How "Critical" Positions Will Be Determined

As stated, the approving authority can designate certain positions as critical, or as necessary to run critical functions and services. The proposed legislation allows for the inclusion of other positions at the discretion of the approving authority. However, the agency will have to find the savings in other areas of the budget if these positions are not furloughed.

Unclear at this point is the specific criteria or overall philosophy the approving authorities will use to determine whether a position is "critical" or performs a critical function. For example:

- Will availability of funding have an impact on determination?
- How will impact to services be gauged to determine if services are being deleteriously impacted and consequently that a furlough may need to be mitigated?
- Because the funding is reduced to individual agencies, will a contingency pool be used or established to allow agencies to suspend the furlough for some positions without having to reduce expenditures elsewhere?

LFD ISSUE

Legal Considerations

Legislative legal staff examined a number of points about the potential legal consequences of a furlough. Please note that legal staff has not conducted a formal legal review.

- No court rulings have been rendered against the use of furloughs in Montana
- There is precedence for a furlough in Montana, when the forced furlough of highway patrol officers in 1986 was upheld (the case took three years to complete)
- Unclear at this point without further legal analysis and review is whether an agency can require additional unpaid and non-voluntary furloughs to meet other personal services reductions. Legislative legal staff was not willing to state that additional, selective furloughs would withstand legal challenge.

At the same time, legislative legal staff was concerned that the furlough could be legally challenged, although the specific issues that might be raised are not clear, nor is whether the challenge would be found to have merit. However, the state could face the expense and effort of legally defending the furlough.

LFD ISSUE

Positions Not Exempted

A number of positions were not exempted from the calculations used to apply savings to agencies that may be considered critical, including psychiatric direct care workers at the state mental health facilities and protective service workers.

The result of inclusion of some positions that will have to be filled or that might otherwise be considered critical could have a cumulative deleterious impact on individual agencies' budgets. This problem may be especially acute in the Department of Public Health and Human Services, which has already taken a number of measures to reduce personal services in order to avoid a supplemental appropriation, including a reduction in protective services staff.

Ongoing? The executive has requested legislation that limits the furlough to fiscal 2003, only. The legislature could extend the furlough indefinitely. However, the legislature may want to consider the overall level of staffing and expectations of both service and delivery rather than continuation of a furlough, which implies that current work requires fewer staff than currently funded, which may not be an accurate assumption.

Hiring Freeze of Non-Critical Positions

The executive proposes to require that all agencies institute a hiring freeze. The proposed statute would state that agencies of state government could not hire any employees after the effective date of the act unless the approving authority[8] approves the hiring in writing. The Montana University System would be exempt. The executive anticipates savings of $1.4 million general fund, which it includes as additional reversions on the proposed balance sheet.

Additional information:

- All positions, regardless of funding source, are included. However, agencies would conceivably be given more leeway to replace non-general funded positions by the approving authority
- The legislation does not specify any criteria under which a position or function would be considered "critical". Therefore, flexibility lies with the approving authority.
- The legislation as requested applies only to fiscal 2003

LFD ISSUE When calculating the potential savings from this proposal, the executive took a "snapshot" of vacant positions at a point in time. Potential savings were then derived by taking those positions, exempting certain positions, allowing for an agency to recover its vacancy savings requirement of 4 percent as determined by the 2001 legislature, and assuming any other savings from maintaining those vacancies for an entire year would be from this hiring freeze. Consequently, the calculation does not:

- Take into account any other personal services reductions proposed by the Governor. Therefore, this requirement of a hiring freeze would not result in any savings to the state until agencies have met their other personal services reductions
- Make allowance if an agency had proposed a hiring freeze to meet any other reduction targets or requirements, either under the reductions in expenditures ordered under 17-7-140, MCA or other budget shortfalls.

LFD ISSUE As stated, it will be up to the approving authority to determine whether a position is critical, or performing a critical function. As a result, the approving authority and not the legislature would be in the position of determining priorities in the provision of state services.

The methodology and philosophy of how agencies will be allowed to hire positions becomes critical for a number of reasons, including but not limited to the following:

- As stated, agencies may have already taken certain actions to limit personal services expenditures, including hiring freezes, and may already be in a disadvantageous position if more vacancies occur.
- The state has historically had difficulty recruiting and hiring certain positions considered in demand either by other governments or the private sector, such as engineers. As a result these positions frequently have high turnover rates within an agency. Consequently, certain programs could quickly reach a significant vacancy level.

---

[8] The Governor or their designated representative for the Executive Branch, the Board of Regents for the Montana University System, the Supreme Court for the Judiciary, the Speaker of the House for the House of Representatives, the President of the Senate for the Senate, the Legislative Finance Committee for the Legislative Fiscal Division, the Legislative Council for the Legislative Services Division, and the Legislative Audit Committee for the Legislative Audit Division.

LFD ISSUE (Cont.)

- o Vacancy patterns can be volatile and extremely difficult to predict, both on an agency and statewide basis.
- o There are multiple approving authorities.

There are two primary questions:

1) How will the approving authority determine whether services are being so severely impacted that recruitment should be allowed to occur? Will any criteria be consistently applied not only from agency to agency but from approving authority to approving authority?
2) As stated earlier, without legislative direction or involvement the approving authority would be delegated the authority to determine priorities of service provision. How will this prioritization occur?

If the legislature approves this proposal, it may wish to consider one or both of the following options:

1) Provide guidance to the approving authorities on how the hiring freeze should be managed and implemented, and which services it considers critical.
2) Require that the approving authorities report to the appropriate interim committees and to the legislature on implementation of the hiring freeze.

LFD COMMENT

The hiring freeze estimation of potential savings would not be applied to each agency in the executive proposal. As stated, the executive took a "snapshot" of vacancies at a point in time. A current snapshot would show different results. Consequently, savings were not applied to agencies based upon vacancies that could have no pertinence to either current or future vacancy patterns.

HB 13 Pay Plan 20 Percent Reduction

This proposal would reduce general fund appropriated for the fiscal 2003 pay plan by 20 percent. The total savings is $4.223 million general fund in fiscal 2003. An additional $200,000 in other funding is requested due to the proposed replacement of general fund in some programs with state special revenue. (For a further discussion, see the "ESA" page 76, "Lodging Facility Use Tax" page 70, and "RIT" page 60, narratives in this volume.)

LFD COMMENT Since the executive would not attempt to re-negotiate the contracts upon which the pay plan funding is based, this proposal increases the vacancy savings requirement on agencies, as they must provide the salary and insurance increases prescribed in law. Pay plan funding for fiscal 2003 was provided to:

1) Pay the costs of a 4 percent salary increase in fiscal 2002 for the first 3 months of fiscal 2003;
2) Pay the costs of a further 4 percent salary increase in fiscal 2003 for 9 months;
3) Pay the increased insurance cost beginning on January 1, 2002 of $30 per month; and
4) Pay the further increase in insurance contributions beginning January 1, 2003 of $41 per month.

The following table shows the reduction to each component of the pay plan. As shown, the reduction would impact executive branch agencies, as well as the Judicial and Legislative Branches, and the Montana University System.

Proposed 20 Percent General Fund Pay Plan Reduction
Fiscal 2003

Agencies/Branch	Initial Appropriation	Proposed Reduction	Adjusted Funding
Legislative Branch	$ 388,359	$ (77,672)	$ 310,687
Consumer Counsel	0	0	0
Judiciary	253,634	(50,727)	202,907
University System	8,759,051	(1,751,810)	7,007,241
OBPP (Executive Branch)	11,606,426	(2,321,285)	9,285,141
OBPP Teacher Pay Plan	107,216	(21,443)	85,773
Total	$ 21,114,686	$ (4,222,937)	$ 16,891,749

The reduction in the pay plan amounts to an additional vacancy savings of about 0.8 percent for an agency whose personal services are funded 100 percent with general fund. Given that the reduction only applies to the general fund, the impact on agencies will not be consistent. The following provides a sampling of the impact on different agencies. Please note that these are department-wide totals. Individual divisions and functions within departments will also be inconsistently impacted.

LFD COMMENT (Cont.)

Impact on Selected Agencies
20 Percent Pay Plan Reduction Proposal
Fiscal 2003

Agency	Fiscal 2002* General Fund PS Funding %	Reduction in Total Pay Plan Funding
Judiciary	87.5%	17.5%
Legislative Branch	67.8%	13.6%
Department of Transportation	0.0%	0.0%
Public Health and Human Services	56.0%	11.2%
Department of Natural Resources and Conservation	57.9%	11.6%
Department of Justice	42.3%	8.5%
Department of Corrections	90.7%	18.1%
Office of Public Instruction	42.7%	8.5%

*Through June.

The cumulative impact of this reduction and other personal services reductions either proposed by the Governor or already in effect are discussed in the narrative entitled "Personal Services Funding Reduction - Cumulative Impact" on page 91.

LFD ISSUE

Personal Services Funding Reduction – Cumulative Impact

The executive proposal for the special session includes three proposals impacting the level of funding available to agencies for personal services expenditures:

1) A two day furlough;
2) A hiring freeze; and
3) A reduction in pay plan funding.

These proposals are in addition to three other actions of either the 2001 legislature or the executive:

4) A 4 percent vacancy savings applied to all positions by the 2001 legislature, with additional reductions in personal services funding for some agencies with general funds
5) Less than full funding of the pay plan approved by the 2001 legislature, beyond the reduction taken for the 4 percent vacancy savings; and
6) A 3.5 percent reduction in spending ordered by the Governor under the authority of 17-7-140, MCA. Although personal services reductions were not specifically targeted, it is likely that at least some agencies will reduce personal service spending by up to 3.5 percent.

While individually the actions taken or proposed to reduce personal services expenditures would appear manageable, cumulatively they could have a major impact on the operation of state agencies. Please note that the impact would not be uniform among agencies as implementation of the reductions contains some variables such as certain positions being exempt from a reduction measure or agencies (in the case of item 6 above) having flexibility in determining where the spending reduction is to occur (personal services or operating). However, for an agency or function entirely funded with general fund, the cumulative impact could be from 6.5 percent to in excess of 10.0 percent.

Because of the variations between agencies, both in fiscal impact and operational impact, it is difficult to gauge the cumulative impacts of personal services reductions on the services each agency provides. In general terms, the legislature needs to consider how significant reductions can affect the services that the agency is expected to provide. Forcing a reduction in personnel resulting from the actions listed above will, in most instances, cause a reduced number of workers to perform their work and the work of positions that are not filled. This workload increase can translate into impacts on the public who seek services from government: slower decisions, delayed permits, delayed benefits, and the inability to perform other timely services, some critical to the health and safety of program clients or the public at large. Impacts of workload increases are in addition to reductions in benefits or services resulting from previous spending reductions. This problem is especially acute in the Department of Public Health and Human Services, where significant actions have been taken since mid-fiscal 2002 to avoid a supplemental appropriation, and where direct care workers at the state's mental health facilities and protective services workers were included in both the hiring freeze or the two-day furlough.

LFD ISSUE (Continued)

LFD ISSUE On July 22, legislative legal staff raised an issue with the constitutionality of the hiring freeze and the two-day furlough as requested. Staff indicated that it might be inappropriate for the legislature given court cases in other states that held that such action was an infringement on the executive's prerogative to supervise, including to establish staffing levels. The legislature may therefore wish to explore other statutory language if it wishes to pursue this policy.

LFD ISSUE If DPHHS were to comply with the furlough and hiring freeze at state institutions, such actions could jeopardize institutional Medicaid and Medicare certification. The state general fund is projected to receive $18.6 million in Medicaid and Medicare reimbursement for institutional services in fiscal 2003. Loss of certification would result in loss of this general fund revenue. The revenue also supports repayment of bonds issued to construct a new state hospital and improvements at the Montana Developmental Center.

In passing the 2001 pay plan, the legislature provided both the executive and the legislative branch with contingency funding should personal services expenditures exceed budgeted amounts. As of this writing (prior to close of fiscal 2002), just under $505,000 of the $1.3 million general fund biennial appropriation to the executive had been expended (the Governor ordered a further $65,000 in spending reductions to this appropriation under 17-7-140, MCA), while $41,500 of the $200,000 contingency to the legislative branch was expended. Therefore, some funding is available to alleviate a portion of the possible impacts of the personal services reductions on staffing levels.

Almost every state worker is hired to fill a position that the legislature and agency managers believed necessary to meet some statutory or policy mandate. A reduction in funding of up to 10 percent for these same positions should include a discussion of the legislature's policy behind the mandate. The legislature may want to consider the elimination of certain statutory mandates to correspond with the reductions in personal services funding.

Personal Car Reimbursement Limit

The executive proposes that any state employee traveling on state business be paid the state rate for using a personal vehicle if a state car is available. If a state car is not available, the employee would be entitled to the mileage prescribed under state law.[9] This change applies to state officers and employees. Members of the legislature and others entitled to mileage would not be affected.

> **LFD COMMENT** General fund expenditures for personal car mileage totaled $831,516 in fiscal 2001. This figure includes all reimbursements made to persons who would be exempt under the proposed statute. The executive estimated that approximately half of those costs could be saved, or $400,000 each year. Savings as a result of this proposal would be included in the ending fund balance. No estimate was made of potential savings to other fund types.

Ongoing? Yes. This change in statute would permanently change the policy regarding reimbursement for personal car mileage.

> **LFD ISSUE** It is not known what if any impact this change in statute would have on demand for state motor pool cars. The legislature may wish to require that a report be provided to the Legislative Finance Committee on the impacts of this change on state motor pool usage and requests for additional vehicles.

[9] The Internal Revenue Service (IRS) rate of $0.365 per mile for the first 1,000 miles and $0.03 less for all additional miles within a given calendar month. The state motor pool rate depends upon the type of vehicle requested. The rate for a mid-size sedan is $0.054 per mile, plus $1.643 per hour (with a minimum of 8 hours).

HB 124 Reductions

Correct County HB 124 Growth Percentages – When HB 124 was approved it inadvertently contained entitlement growth rates for county and consolidated county entitlements of 3 percent in fiscal 2002 and 2003. The legislature intended to codify a growth rate of 2.3 percent for county entitlements and 2.65 percent for consolidated county entitlements for each year of the 2003 biennium. The executive proposes to apply these intended rates retroactively to fiscal 2002 and 2003 entitlement payments by adjusting the fiscal 2003 payments downward by a total of $430,000.

HB 124 Technical Correction to District Block Grants – The executive proposes to reduce HB 124 block grants to school districts. The appropriations for HB 124 block grants to school districts were based on the amount of motor vehicle revenue that would have been distributed to the state had HB 540 been in effect for all of fiscal 2001. HB 540 instituted a new flat fee on light vehicles based on age beginning January 1, 2001, halfway into fiscal 2001. In HB 124, schools were granted block grants for fiscal 2002 based on 93.4 percent of fiscal 2001 vehicle revenues. This percentage was designed to adjust fiscal 2001 vehicle fee revenue to reflect a full year's worth of receipts under the flat fee system. Later analysis determined that the light vehicle adjustment to fiscal 2001 collections should have been 88.6 percent, the percentage used by cities and counties in calculation of their HB 124 entitlements. Recalculating school district block grants by utilizing the lower adjustment percentage for both fiscal 2002 and 2003 saves the state $1.8 million in HB 124 block grant payments. The state will be required to backfill a portion of this amount with guaranteed tax base in the amount of $625,000. Thus, the net savings to the state general fund is $1.2 million in fiscal 2003.

LFD COMMENT Expenditures on HB 124 block grants to school districts were reduced earlier in fiscal 2002 by $6.4 million for the 2003 biennium when it was determined that the biennial appropriation for this purpose was too high. The appropriation had been based on estimated fiscal 2001 revenue received by districts, which turned out to be lower than expected. Local district property taxes will increase by the amount of the state savings.

HB 124 Technical Correction to County Education Block Grants – The executive proposes to reduce HB 124 block grants to county education funds (elementary and high school retirement and transportation). The appropriated HB 124 block grants to the county education accounts were intended to be based on actual fiscal 2001 revenues which were not known but were estimated at the time HB 124 passed the 2001 legislature. Actual fiscal 2001 receipts were lower than these estimates. In addition, the original appropriation estimates did not correctly adjust fiscal 2001 light vehicle revenue for HB 540. The estimates were based on an adjustment factor of 93.4 percent of fiscal 2001 light vehicle revenue. The executive proposes to adjust fiscal 2001 light vehicle revenue by 88.6 percent, the same percentage used by cities and counties in the calculation of their HB 124 entitlements. The executive proposes to reduce block grant amounts to the county education accounts for fiscal 2002 and 2003, all of which will be effective in fiscal 2003. The savings to the state in HB 124 payments will be 1.3 million. Guaranteed tax base aid in the county retirement funds will increase by $0.3 million.

LFD COMMENT The reduction in state block grants to the county education accounts will increase county property taxes by $1.1 million in fiscal 2003.

Eliminate Distributions to 6 mill levy – The executive proposes to eliminate HB 20 distributions to the six mill levy account for fiscal 2003 and beyond. HB 20 was passed during the 1989 session and reduced business equipment tax rates to 9 percent and reimbursed all local jurisdictions and the six mill levy account for the lost revenue. Eliminating this distribution will save $210,000 in general fund expenditures in fiscal 2003.

Bozeman Gambling Accrual – The executive proposes to increase the HB 124 entitlement to Bozeman city by $220,000. In determining Bozeman's entitlement payment, gambling revenue receipts in fiscal 2001 were based on only three quarters worth of gambling revenues since the city is on an accrual basis. The city has asked that their entitlement be increased by the fourth quarter of receipts, or $220,000.

US Mineral Royalties Distribution

The executive proposal will increase US Mineral Royalty revenues to the general fund for fiscal 2003. HB 11, August 2003 Special Session, establishes a higher level of collections that must be met before the counties receive their share of the mineral royalties. For fiscal 2003 only, the level is changed from $20.5 million to $24.2 million. For subsequent years the proposal reduces the percent of the royalty distributions flowing to counties as seen in the table below. The executive estimates the increase to the general fund at $740,000.

US Mineral Royalties

FY	Current Law	Executive Proposal
2003*	$20.474	$24.164
2004	12.5%	5.0%
2005	25.0%	10.0%
2006	25.0%	25.0%

* in millions of dollars and all in excess goes to counties

Elimination of the Liquor Store Incentive

In the 2001 legislative session, HB 348 was passed, providing additional financial incentives for agency liquor stores based on their annual volume of sales. The executive proposal would eliminate all the incentives, leaving the increased commissions in effect for the first two months of fiscal 2003. The fiscal note that accompanied HB 348 determined a general fund impact of ($288,608) in fiscal 2003. The executive estimates that the elimination of the liquor store incentive will increase the general fund by $235,000 by increasing net liquor revenues and therefore increasing the amount of the statutory transfer to the general fund. The LFD estimates the increase at $240,507.

2005 BIENNIUM GENERAL FUND OUTLOOK

In a series of reports by the LFD on the General Fund Status since November 2001, this office has reported that the state faces not only a significant 2003 biennium deficit, but an even more serious long-term structural imbalance between ongoing expenditures and state revenues. A flat revenue base combined with ever increasing expenditures further exacerbates the structural imbalance problem. The current broadbrush projection is an imbalance of over $230 million just to fund a present law budget. The size of the imbalance is a major fiscal issue that will have to be addressed by the 2003 legislature. An accurate estimate of the imbalance is difficult to predict, since it is dependent on the strength of state and national economies and the growth in state expenditures.

The purpose of this section is to provide insight into the severity of the budget deficit from a longer term perspective, and in particular, to provide a framework for evaluating the executive budget plan from a longer term outlook. This might include adopting options to reduce future biennium imbalances as part of the more immediate current biennium deficit resolution. The executive plan includes budget balancers that have an ongoing impact and contribute to resolving the long-term problem, although the majority do not address the long-term structural imbalance.

DETERIORATING TAX BASE

It has become clear that the state general fund tax base has declined, primarily with regard to individual and corporate income tax collections. The prevailing question is how soon and to what extent will the base recover. The state's tax base increased significantly on the volume of capital gains increase that was reported during the extraordinary bull market years of the 1990s. The associated tax revenues were used to expand the expenditure base. It is now clear that the revenue bubble from capital gains income growth has burst, resulting in a permanent reduction in the general fund revenue base. An accurate analysis of the impact of capital gains revenue declines will not be possible until late 2002.

STRUCTURAL IMBALANCE

LFD staff kept a constant tally of the potential structural imbalance in the general fund during the 2001 session, and reported in the post-session Legislative Fiscal Report that there was a structural imbalance of $57 million in the 2003 biennium budget. A structural imbalance means that on-going expenditures base exceeds on-going revenues by $57 million (this was largely attributable to spending down a large fund balance, a one-time source of revenue, to support expanded or new programs). This calculation was based on the revenue estimates included in HJR 2, the revenue estimating resolution. As projected by this office, the general fund revenue shortfall from HJR 2 levels is $145 million. To the extent that this shortfall is permanent, a direct increase in the structural imbalance is created. Based on the LFD projections, the structural imbalance has grown to $234 million. This represents the reduction in revenues that are available to the legislature to continue ongoing programs, and when coupled with the costs of annualization of delayed implementation programs, such as the state pay plan and K-12 BASE aid increases, the shortfall mushrooms to over $250 million. And with the potential of anemic growth rate in general fund revenues, the legislature may have to consider significant budget reductions and/or revenue enhancements to balance the budget.

If the legislature during the next regular legislative session incorporates the 2003 spending reductions in each year of the 2005 biennium budget, the structural imbalance will be reduced correspondingly.

A non-general fund account with a chronic structural imbalance is the highways special revenue account. In view of the fact that revenue growth in the account does not keep pace with expenditures for highway construction and maintenance that are subject to high inflation, the executive proposal to fund $8.3 million of program costs currently funded by the general fund will expedite the ultimate insolvency of the account. It would then require either a revenue increase or a reduction in expenditures. Expenditure reductions could translate over the long-term into a loss of federal match funds and reduced highways funding.

Impact of Current Reduction – One-Time vs. Ongoing

The executive budget plan includes an estimated $22 million in potentially permanent expenditure reductions. Those reductions will contribute to reducing the structural imbalance in the general fund, provided the reductions are incorporated in the 2005 biennium budget.

Expenditures

Pressures on spending for government services, including double-digit growth in human services programs (resulting from increased caseloads, Medicaid cost increases, and runaway prescription costs) will further complicate the budget deficit in the 2005 biennium. Correction costs due to a filled-to-capacity prison system will further add to spending pressures. Demands for increased support of education will continue to be heard, and wildfire suppression costs will likely exceed average annual costs until the drought is subsides. This will make the job of prioritizing/scaling back the expenditure base extremely difficult.

Potential Legislative Response in 2003 Session

As part of a long-term solution to the current budget crisis, the legislature may want to evaluate options for improved budget management and tools to address temporary downturns in the state budget picture. The following discussion addresses three options for managing future budget deficit crises.

Assessment of Appropriate General Fund Reserve

The economic outlook for the state is very tenuous at best. The more stable and robust economic times of the 1990's are in the past. Attaining general fund budget stability is more than setting appropriations equal to anticipated revenues. There is a need for a positive ending fund balance projection to serve as a safety net. The adequacy of the reserve can buffer the state from the consequences of fiscal instability due to the volatility in revenue collections. The level of fund balance reserves must be sufficient to offset unforeseen economic events that trigger shortfalls. To this end, the legislature needs to evaluate what amount of ending fund balance is sufficient to ensure budget stability.

For several biennia during the 1990s and before, the legislature set an ending fund reserve of $20 to $25 million, which was barely 1 percent of biennial appropriations. This reserve was near the trigger amount for spending reductions defined in statute. National fiscal experts such as the National Conference of State Legislatures recommend a fund balance reserve of 3 to 5 percent of total appropriations or revenues. At the current budget level, this would amount to a reserve of at least $80 million. The average state reserve projection in fiscal 2001 was over 5 percent. The 2001 Montana legislature established the largest projected reserve in history when it set the 2003 biennium projected ending fund balance at $54 million, or just over 2 percent of total appropriations. While still well below the recommended level and the all-state average, this ending fund balance reserve was not enough to avoid a budget deficit. The higher reserve did contribute to reducing the size of the deficit. This points out the importance of establishing an adequate reserve that takes into consideration the volatility of the state economic picture.

Attention to Structural Imbalance

The legislature has worked diligently to pass a budget that is structurally balanced over the past several biennia. The budget pressures of the 2001 session resulted in a general fund budget that was structurally imbalanced by at least $57 million. This built-in imbalance, when coupled with the dramatic decline in general fund revenues has expanded the structural imbalance to $230 million. This creates a serious underlying budget imbalance that will have to be addressed by the 2003 legislature. Establishment of balance between the ongoing revenues and the expenditures is critical to long-term budget stability. The LFD staff will continue to track the structural balance during the session to assist the legislature in achieving a healthy budget base structure.

Establishment of Rainy Day Fund

The current crisis in state general fund budgets has forced at least 48 states to take action to bring their budgets back into balance due to revenue shortfalls. A majority of those states utilized the proceeds of a rainy day fund as part of the solution to their budget shortfall. A total of 46 states have rainy day funds to help get through periods of budget volatility. One of the four remaining states has a statutory requirement that the minimum ending fund balance projection must be at least 7.5 percent of total revenues, which has the same effect as a rainy day fund. A rainy day fund is a prudent tool to avoid the disruption of state services and the crisis management necessary in a budget deficit situation. Rainy day funds usually have strict criteria for withdrawal of funds from the account, and have effectively served states that invested in them.

APPENDIX A

Special Session Proclamation

June 28, 2002

To: Members of the Montana Senate
Members of the Montana House of Representatives
Members of the Montana Supreme Court c/o Clerk of the Court Ed Smith
Secretary of State Bob Brown

PROCLAMATION

Call to the 57th Legislature for a Special Session

WHEREAS, Article V, section 6, of the Montana Constitution and section 5-3-101, MCA, provide that the Legislature may be convened in special session by the Governor; and

WHEREAS, Article VI, section 11, of the Montana Constitution provides that whenever the Governor considers it in the public interest, the Governor may convene the Legislature; and

WHEREAS, general fund revenues are anticipated to fall short of Legislative projections for FY2003; and

WHEREAS, in an effort to ensure that the expenditure of appropriations do not exceed available revenue, the provisions of section 17-7-140, MCA, were invoked directing agencies to reduce spending in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1% of all general fund appropriations during the biennium ending June 30, 2003; and

WHEREAS, based upon the revenue estimates available at the time that the budget director notified the legislative fiscal analyst, the legislative finance committee, and the revenue and finance committee pursuant to the requirements of section 17-7-140, MCA, the budget director recommended a 3 ½ % reduction in general fund expenditures; and

WHEREAS, a 3 ½ % reduction in general fund expenditures is being implemented based upon the information available at the time of commencing the process required under section 17-7-140, MCA; and

WHEREAS, based upon a continuing review and analysis of declining revenues to the state general fund, the budget director projects a general fund budget deficit that may not be met by a further directive to reduce spending beyond the current 3 ½ % reduction because of the limitations in section 17-7-140, MCA; and

WHEREAS, it is in the public interest of all Montanans that the programs funded through general fund expenditures by the Fifty-Seventh Legislature be considered at a special session of the Legislature; and

WHEREAS, it is in the public interest of all Montanans that a special session of the Legislature be called for the limited purpose of approving fund balance transfers, reducing general fund expenditures, reducing non-general fund appropriations and nonbudgeted transfers, reducing the general fund shortfall in revenue to meet the declining revenue projections for the 2003 biennium, and providing a guarantee account in the state special revenue fund.

NOW, THEREFORE I, Judy Martz, Governor of the State of Montana, pursuant to the authority vested in me by the Constitution and laws of the state of Montana do hereby call the Fifty-Seventh Legislature into Special Session in Helena, at the Capitol Complex at the hour of 9:00 a.m., the 5th day of August, 2002, and hereby direct the Special Session of the Fifty-Seventh Legislature to consider action limited to the following subjects:

1. Legislation approving fund balance transfers as submitted by the Office of Budget and Program Planning.
2. Legislation reducing general fund expenditures, including general fund expenditures exempted by section 17-7-140, MCA, House Bill 2, any other appropriation bill, statutory appropriation, or language appropriation.

3. Legislation reducing non-general fund appropriations and nonbudgeted transfers when the reduction will increase the general fund balance and any necessary statutory amendments to effectuate the legislative reductions.
4. Legislation reducing the general fund shortfall in revenue.
5. Legislation amending House Bill 41 and Senate Bill 495 to provide for a guarantee account in the state special revenue fund.

Dated this 28th day of June, 2002.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the Great Seal of the State of Montana to be affixed. DONE at the City of Helena, the Capitol, this 28th day of June, in the year of our Lord, two thousand and two.

JUDY MARTZ, Governor

ATTEST:

BOB BROWN, Secretary of State

APPENDIX B

2003 Biennium General Fund Balance
Based on Action By the 57th Legislature and LFD Revisions
In Millions

	Actual Fiscal 2000	Actual Fiscal 2001	Estimated Fiscal 2002	Estimated Fiscal 2003	Actual 2001 Biennium	Estimated 2003 Biennium
Beginning Fund Balance	**$109.673**	**$176.000**	**$172.897**	**$85.671**	**$109.673**	**$172.897**
Revenues						
Current Law Revenue	1,163.641	1,269.472	1,269.529	1,262.135	2,433.113	2,531.664
Legislation Impacts						
Residual Transfers	0.725	0.501			1.226	
Total Funds Available	**$1,274.039**	**$1,445.973**	**$1,442.426**	**$1,347.806**	**$2,544.012**	**$2,704.561**
Disbursements						
General Appropriations	1,046.100	1,140.620	1,120.810	1,153.313	2,186.720	2,274.123
Statutory Appropriations	39.950	76.219	149.845	130.061	116.169	279.906
Local Assistance Appropriations	13.813	56.772			70.585	
Miscellaneous Appropriations	3.890	7.408	71.748	89.162	11.298	160.910
Language Appropriations						
Non-Budgeted Transfers	2.350	3.227	21.636	15.886	5.577	37.522
Continuing Appropriations			2.611			2.611
Supplemental Appropriations				17.366		17.366
FEMA Wildfire Costs						
Feed Bill Appropriations				7.028		7.028
Executive Reductions				(23.400)		(23.400)
Legislative Reductions				(0.350)		(0.350)
Anticipated Reversions	(0.505)	(15.321)	(7.571)	(6.698)	(15.826)	(14.269)
Total Disbursements	**$1,105.598**	**$1,268.925**	**$1,359.079**	**$1,382.368**	**$2,374.523**	**$2,741.447**
Adjustments	7.559	(4.151)	2.324		3.408	2.324
Reserved Ending Fund Balance	**$176.000**	**$172.897**	**$85.671**	**($34.562)**	**$172.897**	**($34.562)**
Unreserved Ending Fund Balance	**$176.000**	**$172.897**	**$85.671**	**($34.562)**	**$172.897**	**($34.562)**

APPENDIX C

Table of Impacts From Executive Budget Plan

	General Fund	Total
Impact on Agency Operations		
2 Day Furlough	($1,052,662)	
Hiring Freeze	(1,400,000)	
HB 13 Pay Plan Reduction	(4,222,937)	
Higher Education Reduction	(3,190,000)	
Lottery Administration	(190,000)	
State Library	(32,879)	
		($10,088,478)
Reductions in Payments to Locals/Individuals/Groups		
HB 124		
Correct County Growth	(430,000)	
6 Mill Levy	(209,912)	
Alcohol Tax for Medicaid*	(1,000,000)	
Liquor Store Incentive	(235,000)	
		(1,874,912)
Reduced Grants to Locals/Individuals/Groups		
Weed Funds	(500,000)	
Certified Communities	(425,000)	
Growth Through Agriculture	(693,000)	
Research and Commercialization	(1,200,000)	
Coal Board Grants	(435,000)	
Conservation Districts	(330,000)	
State Library Grants	(97,217)	
		(3,680,217)
Reduced Payments for Schools		
HB 124	(2,254,577)	
Other Reductions		
Flex Fund	(4,616,000)	
Timber Harvest Technology	(2,300,000)	
DSA to GTB 0.3 Percent Change	(1,151,000)	
Bozeman Accrual	220,000	
		(10,101,577)
Potential Long-Term Impact		
Transfer Highways State Special to MVD	(8,240,751)	
Orphan Share Transfer to General Fund	(1,000,000)	
Parks Trust	(408,000)	
Accommodations Tax Fund Switch*, **	(1,915,000)	
Fund Balance Transfer - RIT	(500,000)	
Metal Mines	(411,000)	
Oil and Gas Severance Taxes	(1,516,000)	
Cultural and Aesthetics Trust	(203,000)	
		(14,193,751)
Other		
Personal Car Reimbursement	(400,000)	
Long-Range Building	(644,000)	
US Mineral Royalties	(740,000)	
Fund Switch ESA Funds	(4,000,000)	
Additional Judiciary	152,137	
		(5,631,863)

*Partial reduction due to reduced payments available.

**Will cause an immediate reprioritization of a portion of reduced fund balance in the Department of Commerce.

APPENDIX D

TOTAL GENERAL FUND SPENDING REDUCTIONS FOR DEPARTMENT OF PUBLIC HEALTH AND HUMAN SERVICES

Proposed and implemented general fund spending reductions in the Department of Public Health and Human Services (DPHHS) total $24 million general fund ($63.5 million total funds) over the 2003 biennium (not including savings due to a hiring freeze). These spending reductions occur due to:

- Proposed funding shifts in the August 2002 special session executive budget proposal
- Proposed personal service reductions for the special session
- Compliance with 17-7-140, MCA
- Actions taken to avoid a supplemental appropriation

The August 2002 special session executive budget proposal for DPHHS contains two funding shifts that reduce general fund by $2.9 million and increase state special revenue by a like amount. General fund supporting the Vocational Rehabilitation program in Disability Services Division is reduced $1.9 million and state special revenue from the Employee Security Account administered by the Department of Labor and Industry is increased $1.9 million. The second funding shift reduces general fund Medicaid match in the Addictive and Mental Disorders Division by $1.0 million and state special revenue is increased with $1.0 million from alcohol tax revenues that are currently distributed to state approved county chemical dependency programs. The net change due to proposed funding shifts within the DPHHS budget is zero.

Personal services funding reductions included in the proposed two-day furlough and pay plan reduction decrease general fund by $1.2 million ($2.1 total funds) in fiscal 2003. DPHHS has not indicated how it will reduce spending to comply with personal services reductions. Since many of the state institution employees are included in the proposed personal services reductions, DPHHS will most likely have to make spending reductions in other areas to maintain Medicaid certification.

Each of these personal service reductions individually has a great deal of impact and combined with previously implemented personal services reductions such as vacancy savings, hiring freezes and other costs containment actions could have substantial impact on some divisions and programs. For example, it was previously reported to the Legislative Finance Committee[10] that: 1) the Child and Family Services Division (CFSD) has left about 25 positions vacant in order to achieve the budgeted level of vacancy savings; and 2) the spending reduction plan, if implemented, would result in an additional 7-8 positions being held vacant raising the total number of vacant positions to 33 or 10 percent of the FTE level funded for CFSD for the 2003 biennium. The calculated saving of the 2 day furlough and 20 percent reduction in pay plan funding is about $162,000 general fund, an amount roughly equivalent to the spending reduction mandated under 17-7-140 MCA. It is probable CFSD will need to hold an additional 7 or 8 positions vacant to achieve this savings, raising the total number of vacancies in this division to 41 or more than 12 percent of the division approved personal services funding level.

---

[10] This information was contained in the Legislative Fiscal Division Analysis, Spending Reductions Proposal, Fiscal 2003, June 7,2002 report presented to the Legislative Finance Committee on June 13 and 14, 2002.

One of the reasons these reductions are significant is because the executive branch will likely change policy so that staff workload is lowered to a level achievable within staffing levels. In the case of child protective services it is likely that: 1) the severity of abuse and neglect that occurs prior to children being removed from their homes will probably increase; and 2) the level of risk remaining in the home when reunification occurs will also increase. Additionally, it is likely that standards utilized to determine when referrals are investigated will be revised so that the number of investigations will be lowered to a level that can be completed by remaining staff.

It should also be noted that while protective service workers were not exempted from these reductions, these workers are required to respond to reports of abuse and neglect 24 hours per day, 7 days per week. Thus, additional personal services funding reductions will likely result in increased demand for overtime, exacerbating management actions needed to maintain expenditures within funding levels.

Additionally, it appears that some direct care positions such as habilitation aides were not exempt from personal services funding reductions. Vacancies in these positions could make it difficult for institutions to demonstrate that active treatment is occurring. Failure to demonstrate that active treatment is being provided to clients could jeopardize Medicaid certification and reimbursement.

It is also unclear how positions already being held vacant impacted the estimated savings generated by a hiring freeze. DPHHS has already implemented a hiring freeze as a cost containment measure designed to maintain expenditures within appropriation levels. It is possible that these savings have been counted twice.

<u>Other Reductions</u>

DPHHS general fund spending has been reduced by $20.4 million ($61.4 million total funds) over the 2003 biennium due to: 1) the implementation of 17-7-140, MCA reductions; and 2) implementation of cost containment actions to mitigate the need for a supplemental appropriation. The changes to the DPHHS budget are summarized in tables, which follow these summary comments. For additional information about specific reductions, please see reports prepared for the Legislative Finance Committee at its December 2001 and May 2002 meetings.

In compliance with 17-7-140, MCA, the Office of Budget and Program Planning implemented general fund spending reductions of $9.6 million in fiscal 2003, with a reduction in total expenditures of $23.2 million for DPHHS. These reductions are 3.5 percent of the $273.1 million general fund base appropriation.

In addition to compliance with 17-7-140, MCA, DPHHS implemented reductions in 2003 biennial general fund expenditures due to projected cost overruns. At the December 2001 and March 2002 meetings, the Legislative Finance Committee reviewed most of the spending reductions made in order to mitigate the need for a supplemental appropriation – $10.8 million general fund and $38.2 million total funds over the biennium.

Department of Public Health and Human Services
Summary of 2003 Biennium Reductions
August 2002 Special Session, 17-7-140, MCA and Supplemental Mitigation

Action	Human & Community Services		Child and Family Svcs		Child Support Enforcement		Health Policy & Services		Addictive & Mental Disorders	
	Gen. Fd.	Total	Gen. Fd.	Total	Gen. Fd.	Total	Gen. Fd.	Total	Gen. Fd	Total
August 2002, Special Session	$ 161,235	$ 363,635	$ 161,871	$ 266,770	$ -	$ 51,316	$ 35,027	$ 142,356	$ 1,380,235	$ 443,005
17-7-140, MCA	1,275,138	2,088,821	996,441	1,578,541	22,500	66,176	1,553,097	5,584,436	2,834,011	6,677,961
Supplemental Mitigation	-	-	-	-	-	-	7,591,497	28,038,472	3,159,894	10,186,436
Total Change by Division	$ 1,436,373	$ 2,452,456	$ 996,441	$ 1,578,541	$ 22,500	$ 66,176	$ 1,553,097	$ 5,584,436	$ 2,834,011	$ 6,677,961
Percent of Total	5.9%	3.9%	4.1%	2.5%	0.1%	0.1%	6.3%	8.8%	11.6%	10.5%

Action	Director's Office		Quality Assurance		Disability Services		Senior & Long Term Care		Operations and Technology		Total	
	Gen. Fd.	Total	Gen. Fd.	Total	Gen. Fd.	Total	Gen Fd.	Total	Gen Fd	Total	Gen Fd	Total
August 2002, Special Session	$ 12,600	$ 35,524	$ 34,789	$ 99,190	$ 2,252,060	$ 473,915	$ 42,869	$ 111,884	$ 54,948	$ 118,658	$ 4,135,634	$ 2,106,253
17-7-140, MCA	128,459	134,359	156,557	208,960	881,392	1,610,597	1,240,325	4,060,074	513,839	1,097,720	$ 9,601,759	$23,107,645
Supplemental Mitigation	-	-	-	-	-	-	-	-	-	-	$10,751,391	$38,224,908
Total Change by Division	$ 141,059	$ 169,883	$ 191,346	$ 308,150	$ 3,133,452	$ 2,084,512	$ 1,283,194	$ 4,171,958	$ 568,787	$ 1,216,378	$24,488,784	$63,438,806
Percent of Total	0.6%	0.3%	0.8%	0.5%	12.8%	3.3%	5.2%	6.6%	2.3%	1.9%	100.0%	100.0%
Total Department Change	$24,488,784	$63,438,806										

Department of Public Health and Human Services
Governor's Executive Budget, Fiscal 2003 - Special Session, August 2002

Action	Human & Community Svcs Gen. Fd	Human & Community Svcs Total	Child and Family Svcs Gen. Fd	Child and Family Svcs Total	Child Support Enfcmnt Gen. Fd	Child Support Enfcmnt Total	Health Policy & Svcs Gen. Fd	Health Policy & Svcs Total	Addictive & Mental Dsrdrs Gen. Fd.	Addictive & Mental Dsrdrs Total
Funding Exchanges	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,000,000	$ -
Statewide Personal Services					-	-				
2 day Furlough	54,984	124,006	55,140	90,873	-	51,316	12,307	50,018	105,039	122,379
20% Pay Plan Decrease	106,251	239,629	106,731	175,897	-	-	22,720	92,338	275,196	320,626
Total Personal Services*	161,235	363,635	161,871	266,770	-	51,316	35,027	142,356	380,235	443,005
Total Change by Division	$ 161,235	$ 363,635	$ 161,871	$ 266,770	$ -	$ 51,316	$ 35,027	$ 142,356	$ 1,380,235	$ 443,005

Action	Director's Office Gen. Fd.	Director's Office Total	Quality Assurance Gen. Fd	Quality Assurance Total	Disability Services Gen. Fd.	Disability Services Total	Snr & LongTerm Care Gen. Fd.	Snr & LongTerm Care Total	Operations & Technology Gen. Fd	Operations & Technology Total	Total Gen. Fd.	Total Total
Funding Exchanges	$ -	$ -	$ -	$ -	$ 1,965,199	$ -	$ -	$ -	$ -	$ -	$ 2,965,199	$ -
Statewide Personal Services												
2 day Furlough	4,417	12,453	12,095	34,485	72,374	119,567	14,784	38,585	18,588	40,140	$ 349,728	$ 683,822
20% Pay Plan Decrease	8,183	23,071	22,694	64,705	214,487	354,348	28,085	73,299	36,360	78,518	$ 820,707	$ 1,422,431
Total Personal Services*	12,600	35,524	34,789	99,190	286,861	473,915	42,869	111,884	54,948	118,658	1,170,435	2,106,253
Total Change by Division	$ 12,600	$ 35,524	$ 34,789	$ 99,190	$ 2,252,060	$ 473,915	$ 42,869	$ 111,884	$ 54,948	$ 118,658	$ 4,135,634	$ 2,106,253
Total Department Change	$ 4,135,634	$ 2,106,253										

*Not including hiring freeze

Note: Amounts are show as positive numbers but all are reductions.

Department of Public Health and Human Services
Summary of Fiscal 2003 Reductions to Implement 17-7-140, MCA

Action	Human & Community Scvs Gen. Fd.	Human & Community Scvs Total	Child & Family Svcs Gen Fd	Child & Family Svcs Total	Child Support Enforcement Gen. Fd.	Child Support Enforcement Total	Health Policy & Scvs Gen. Fd.	Health Policy & Scvs Total	Addictive & Mental Disorders Gen. Fd.	Addictive & Mental Disorders Total
Provider Rate Reductions	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,363,875	$ 5,038,326	$ -	$ -
Service Limitations/Reductions	1,275,138	2,088,821	739,417	1,113,230	-	-	189,222	546,110	2,323,180	5,939,273
Incr Client Financial Participation	-	-	-	-	-	-	-	-	80,291	80,291
Personal Service Reductions	-	-	195,272	355,040	22,500	66,176	-	-	294,044	501,405
Operating Plan Reductions	-	-	61,752	110,271	-	-	-	-	136,496	156,992
Total Change by Division	$ 1,275,138	$ 2,088,821	$ 996,441	$ 1,578,541	$ 22,500	$ 66,176	$ 1,553,097	$ 5,584,436	$ 2,834,011	$ 6,677,961

Action	Director's Office Gen. Fd.	Director's Office Total	Quality Assurance Gen. Fd.	Quality Assurance Total	Disability Services Gen. Fd.	Disability Services Total	Senior & Long Term Care Gen. Fd.	Senior & Long Term Care Total	Operations & Technology Gen. Fd.	Operations & Technology Total	Total Gen. Fd	Total Total	Percent of Total
Provider Rate Reductions	$ -	$ -	$ -	$ -	$ -	$ -	$ 205,609	$ 642,726	$ -	$ -	$ 1,569,484	$ 5,681,052	24.6%
Service Limitations/Reductions	115,538	115,538	21,218	21,218	881,392	1,610,597	963,002	3,345,634	-	-	$ 6,508,107	$ 14,780,421	64.0%
Incr Client Financial Participation	-	-	-	-	-	-	-	-	-	-	$ 80,291	$ 80,291	0.3%
Personal Service Reductions	9,121	9,121	-	-	-	-	41,714	41,714	17,139	38,087	$ 579,790	$ 1,011,543	4.4%
Operating Plan Reductions	3,800	9,700	135,339	187,742	-	-	30,000	30,000	496,700	1,059,633	$ 864,087	$ 1,554,338	6.7%
Total Change by Division	$ 128,459	$ 134,359	$ 156,557	$ 208,960	$ 881,392	$ 1,610,597	$ 1,240,325	$ 4,060,074	$ 513,839	$ 1,097,720	$ 9,601,759	$ 23,107,645	100.0%
Total Department Change	$ 9,601,759	$ 23,107,645											

Department of Public Health and Human Services Summary of 2003 Biennium Reductions - Supplemental Mitigation							
	Health Policy & Srvcs		Addictive & Mental		Total		Percent
Action	Gen. Fd.	Total	Gen. Fd.	Total	Gen. Fd.	Total	of Total
Provider Rate Reductions/Delays	$ 2,672,348	$ 9,868,388	$ 641,181	$ 885,258	$ 3,313,529	$ 10,753,646	28.1%
Increased Client Financial Participation	841,965	3,109,371	200,000	738,485	1,041,965	3,847,856	10.1%
Service Limitations/Reductions	3,672,733	13,567,538	1,518,713	5,607,392	5,191,446	19,174,930	50.2%
Other	404,451	1,493,175	800,000	2,955,301	1,204,451	4,448,476	11.6%
Total Reduction by Division	$ 7,591,497	$ 28,038,472	$ 3,159,894	$ 10,186,436	$ 10,751,391	$ 38,224,908	100.0%
Total Department Reduction	$ 10,751,391	$ 38,224,908					

Department of Public Health and Human Services
2003 Biennium Reductions - Supplemental Mitigation

Action	Health Policy & Srvcs Gen. Fd.	Health Policy & Srvcs Total	Addictive & Mental Gen. Fd.	Addictive & Mental Total	Total Gen. Fd.	Total Total	Percent of Total
Provider Rate Reductions/Delays							
Reduce Reimbursement Rates 2.6 percent	$ 308,337	$ 1,136,936	$ 51,598	$ 190,258	$ 359,935	$ 1,327,194	
Eliminate Frontier Rate Differential			165,423	195,000	165,423	195,000	
Eliminate Room and Board Payment for Youth	-	-	424,160	500,000	424,160	500,000	
Pharmacy - Increase AWP to 15 percent	965,753	3,567,614			965,753	3,567,614	
Reduce Percentage Paid Co-Surgeons, ASC	126,564	467,328			126,564	467,328	
Reduce Out of State Reimbursement - Hospitals	307,360	1,134,903			307,360	1,134,903	
Change in Reimbursement Critical Access Hospitals	619,571	2,288,009			619,571	2,288,009	
Hospital - Eliminate Catastrophic Case Payments	344,763	1,273,598	-	-	344,763	1,273,598	
Subtotal Rate Reductions	2,672,348	9,868,388	641,181	885,258	3,313,529	10,753,646	28.1%
Increased Client Financial Participation							
Change Client Share to co-insurance	655,665	2,421,155	200,000	738,485	855,665	3,159,640	
Change Bills that Count Toward Incurrement	186,300	688,216	-	-	186,300	688,216	
Subtotal Increased Client Financial Participation	841,965	3,109,371	200,000	738,485	1,041,965	3,847,856	10.1%
Service Limitations/Reductions							
Stricter Documentation Standards			247,713	914,520			
Limit Residential Treatment - Out of State and Clarify Scope			81,000	299,041			
Prior Authorization of Outpatient Therapy			450,000	1,661,335			
Eliminate Outpatient, Rehab Services, school based			225,000	830,668			
Reduce Case Management for Youth in Ther. Living			165,000	609,156			
Reduce "Care Coordination" Services			120,000	443,023			
Eliminate "Full Day" Treatment for Adults			230,000	849,649			
Limit Adult Dental Coverage to Basic Services	425,078	1,570,292					
Eliminate Second 6 Months of Extended Medicaid	679,338	2,509,560					
Freeze Medically Needy Income Level	160,779	593,938					
Drop the Extended Medicaid Waiver	282,396	1,043,207					
Implement Waiver to Reduce Services to Able Bodied	2,125,142	7,850,541	-	-	-	-	
Subtotal Service Reductions/Limitations	3,672,733	13,567,538	1,518,713	5,607,392	5,191,446	19,174,930	50.2%
Other							
Refinance School Based Services			800,000	2,955,301			
Increase Third Party Liability Recoveries	404,451	1,493,175	-	-	-	-	
Subtotal Personal Services Reductions	404,451	1,493,175	800,000	2,955,301	1,204,451	4,448,476	11.6%
Total Reduction by Division	$ 7,591,497	$ 28,038,472	$ 3,159,894	$ 10,186,436	$ 10,751,391	$ 38,224,908	100.0%
Total Department Reduction	$ 10,751,391	$ 38,224,908					

APPENDIX E

DPHHS Supplemental Appropriation

The Office of Budget and Program Planning notified the Legislative Finance Committee in June 2002 that the DPHHS would seek a supplemental appropriation of $3.9 million general fund from the 2003 legislature equal to the amount of additional general fund revenue generated by billing for Medicaid eligible services provided at the Montana Developmental Center prior to January 2002. However, the supplemental appropriation may total $6.7 million general fund or $2.8 million greater than originally estimated by DPHHS.

The increase is due to a likely delay of at least one year in implementing a cost containment measure included in an earlier plan to mitigate potential 2003 biennium general fund cost overruns. DPHHS proposed implementing a waiver of federal Medicaid regulations to provide a limited package of services to able-bodied adults, primarily those receiving family Medicaid. The waiver would maintain current Medicaid benefits for children and aged, blind, and disabled persons. For able-bodied adults, the waiver would:

- eliminate coverage of some optional services such as outpatient mental health services and free standing kidney dialysis
- limit some optional services such as prescription drugs
- limit mandatory services such as physician and hospital visits.

A separate group within the family Medicaid group number includes about 1,400 persons diagnosed with a severe and disabling mental illness. The waiver would allow these individuals to receive an enhanced package of benefits to continue receiving treatment for their mental illness.

Finally, Medicaid eligibility would be expanded to allow a number of adults now eligible for the state Mental Health Services Plan (MHSP) to become Medicaid eligible. Under the waiver, this new group would continue to receive the same services as provided under MHSP and would also receive a limited number of physical health services including physician and hospital services.

MHSP is primarily funded with general fund, while Medicaid services are funded 28 percent general fund. There will be a net general fund savings despite this expansion, as long as Medicaid services are not increased greatly beyond those services already received by MHSP eligible persons.

LFD ISSUE Statue requires agencies to maintain expenditures within existing appropriations. Section 17-7-311, MCA also requires the Office of Budget and Program Planning to present a plan to maintain expenditures within appropriations if it authorizes a transfer of agency appropriation authority from the second to the first year of the biennium. The executive did not present a plan to maintain expenditures within existing appropriations in compliance with section 17-7-311, MCA when it transferred $3.9 million general fund from fiscal 2003 appropriations to fiscal 2002 appropriations in DPHHS. The legislature may wish to ask the executive how it will comply with statute and how it will address the new potential $2.8 million general fund shortfall in order to determine whether it would support such policies and expenditure reductions, recommend other actions, or raise appropriations for DPHHS.

300 copies of this public document were published at an estimated cost of $2.50 per copy, for a total of $750.00, which includes $750.00 for printing and $0.00 for distribution.